GLOBAL REINSURANCE

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THE CASE FOR ARBITRATION

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OVER the years, European and other non-American reinsurers have expressed a great deal of criticism (much of it deserved) of the US judicial system. Generally, the reinsurers' antipathy was based not upon direct experience as parties to a litigation, but rather upon their experience as interested spectators who watched the US courts hand down expansive reading of their cedents' policies and award large verdicts against the direct insureds. Recently, however, for better or worse, reinsurers have found themselves more frequently enmeshed in American courts as parties to those proceedings.

A number of factors contribute to this trend. First, there appears to be an ever-increasing number of reinsurance disputes, and since some reinsurance contracts, particularly facultative contracts, do not contain arbitration clauses, there will be more litigations. Secondly, certain companies and their lawyers are apparently becoming dissatisfied with the arbitration process because they do not perceive that there are any significant cost savings, are displeased with the results and/or perceive the results to be irrational. Despite arbitration's failings, we remain a staunch advocate of it as a means of resolving disputes between reinsurance partners. As such, some of these companies are not including arbitration clauses in their newer contracts. Further, once disputes have developed, there are more instances where both parties are explicitly waiving their rights to arbitration and agreeing to judicial resolution because of generalized dissatisfaction with the arbitral process or because they perceive that there is some tactical advantage to be gained by litigation in this particular case.

Even where the dispute (or a portion of the dispute) is arbitrated, parties are increasingly calling upon courts to resolve issues that arise before, during and after the arbitral process. For example, courts have been called upon to resolve disputes regarding the scope of the arbitration clause, whether non-parties to the agreement may be compelled to arbitrate and whether they are subject to discovery, subpoenas and motions to confirm or vacate arbitration awards. Recently, there have been instances were cedents demanded arbitration to recover on unpaid claims and, at the same time, brought lawsuits to recover punitive damages and/or treble damages imposed under a state's statute. When the reinsurer seeks to have these additional claims decided by the arbitral panel, the court must decide whether the arbitration clause is broad enough to encompass such claims and/or whether it is contrary to the relevant state's public policy for an arbitration forum to determine such issues.

Finally, reinsurers are drawn into the judicial system as a result of the insolvencies of US domiciled insurers. The issue on which parties go to law most often is the extent to which reinsurers' common law and contractual rights of setoff may be abrogated as a result of the insurer's insolvency. Other litigated issues include: the legality of dollar caps on setoff; the terms of the plan of distribution for the insolvent company's remaining unencumbered assets; challenges to the adequacy of both pre- and post-liquidation commutation agreements; and the post-insolvency viability of arbitration clauses. Furthermore, solvent reinsurers may be sued directly by the insured. Generally, such suits are summarily dismissed because the direct insured and reinsurer are not in privity of contract. On at least one occasion, however, such a suit has been permitted to continue pursuant to a rather unique fronting arrangement.

What follows is an attempt to give the reader some insight into the types of disputes which have been litigated recently and an idea as to how the US courts have resolved them. This is not intended to be a comprehensive analysis of recent developments but simply a brief look at some of the more significant and interesting recent decisions.

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One case that has generated particular interest is *In re Insurance Antitrust Litigation*, 723 F Supp 464 (ND Cal 1989), rev'd N° 89–16405 et al [9th Cir 18 June 1991] (availableon WESTLAW at 1991 WL 102975), the anti-trust suit brought by certain states' attorneys general with 'copycat' complaints filed by private plaintiffs. Among the defendants are various European insurers and American reinsurers accused of conspiring to restrict the availability of certain policy coverages. The suit has been dismissed on the basis of the McCarran-Ferguson Act (under which the business of insurance is regulated by the states and thus is largely immune from anti-trust laws); but on 18 June 1991 a three-judge panel of the United States Court of Appeals for the Ninth Circuit reversed this decision and reinstated the litigation. The defendants have petitioned the Ninth Circuit for an *en banc* hearing.

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The meaning of the Second Circuit's holding in *Bellefonte Reinsurance Co v Aetna Casualty & Surety Co.*, 903 F 2d 910 (2d Cir 1990), has been the subject of great debate. Much of the confusion apparently stems from the court's incomplete description of the factual background of the case. In *Bellefonte*, the court held that it would not allow the reinsured to recover defense costs from its facultative reinsurers beyond an 'express' cap on liability set forth in the facultative certificates. *Bellefonte* involved Aetna's insurance of A.H. Robins Company Inc which had manufactured, marketed and distributed the Dalkon Shield. Despite the fact that its policies expressly included defense costs within limits, Aetna settled with Robins under a peculiar factual background by, *inter alia* paying defense cost in excess of policy limits. Aetna argued that, nevertheless, its reinsurers should be liable for their *pro rata* share of the full settlement in excess of the certificates' stated limits because each facultative certificate contained both a 'follow the fortunes' clause and a clause providing that the reinsurer would pay its proportion of the claim" . . . and in addition thereto, in the ratio that the Reinsurer's loss payment bears to the Company's gross loss payment, its proportion of expenses . . . incurred by the Company in the investigation and settlement of claims or suit . . . "

The reinsurers had issued standard facultative certificates but, in a critical fact not set forth clearly in the court decision, most of the certificates were endorsed to provide specifically that the limits were inclusive of defense costs. The Second Circuit refused to conform the certificates to Aetna's settlement and rejected Aetna's contention that the 'follow the fortunes' clauses should override the certificate's express limitations on liability. The court said that the reinsurers should not pay more than their express limits of liability and held that any other interpretation "would strip the limitation clause and other conditions of all meaning; the reinsurer would be obliged merely to reimburse the insurer for any and all funds paid. Such a reading would be contrary to the parties' express agreement and to the settled law of contract interpretation."

Incidentally, the *Bellefonte* court declined to follow the reasoning in *Penn Re Inc and Calvert Insurance Co v Aetna Casualty & Surety Co*, N° 85–385-Civ-5 [EDNC June 29 1987] (available on LEXIS at 1987 US Dist LEXIS 15252), in which the court found that two of Aetna's other facultative reinsurers were bound to pay their full share of Aetna's settlement. Again, the court's factual description is unclear, but it appears the facultative certificates at issue did not contain endorsements specifically providing that the limits were inclusive of defense costs. The *Penn Re* court seemed to hold that the "In addition to . . . " language in the standard certificate made clear that the certificate's stated limits were for indemnity only. Thus, the certificates provided for *pro rata* reimbursement of defense costs in addition to the stated limits despite the fact that the underlying policy's limits were structured otherwise.

Now, *Unigard Security Insurance Co v North River Insurance Co*, N° 88 Civ 0789 (RWS) (SDNY 13 July 1990) (available on LEXIS at 1990 US Dist LEXIS 8610), modified, 762 F Supp 566 (SDNY 1991), also addressed the 'follow the fortunes' clause, this time in connection with the payment of asbestos losses to Owens Corning. Unigard, the reinsurer, had contented that its reinsured's entry into the Wellington Agreement (an asbestos claims facility established in 1985) without prompt notice to Unigard had deprived Unigard of its contractual right to associate and had materially increased the risk reinsured. While North River's involvement with the facility ended before the claims reinsured by Unigard were paid, Unigard argued that the layers underlying it were eroded more quickly.

The court rejected Unigard's arguments,

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holding that Unigard had not proven that the Wellington Agreement's use of a producer allocation formula increased Owens Corning's liability or that the facility's adoption of the triple trigger constituted a deviation from the coverage rule that otherwise would have been applied. Consistent with most recent American court decisions, the *Unigard* court described the rule as follows: "While a 'follow the fortunes' clause does not obligate the reinsurer to pay for settlements which encompass losses outside the scope of the insurance coverage, the reinsurer may not second guess the cedent's good faith decision to pay any claim that is arguably subject to coverage."

Then, *Unigard* also involved the late notice issue. Traditionally, in analyzing whether a reinsurer could deny a claim for late notice, courts in the USA have used the same standards as those governing whether an insurer could deny a claim on that basis. In New York, an insurer generally need not prove prejudice to deny such a claim, and reinsurers similarly argued that they were not required to do so. In New York, however, this issue is not completely settled.

In *Travelers Insurance Co v Buffalo Reinsurance Co,* 735 F Supp 492 (SDNY), vacated on other grounds, 739 F Supp 209 (SDNY 1990), the court held that no basis exists for distinguishing reinsurance from primary insurance with respect to notice provisions. In *Christiana General Insurance Corp v Great American Insurance Co,* 745 F Supp 150 (SDNY 1990), however, the court held that reinsurers must show prejudice from allegedly late notice in order to avoid liability under reinsurance contracts because the policy considerations underlying New York's rule on direct insurers are not present in a reinsurance contract. In so holding, the court reasoned that: "Reinsurers have no duty to defend claims, nor is the potential staleness of a claim as significant a concern to a reinsurer as it is to a primary insurer."

The *Unigard* court agreed with the *Christiana* court's analysis, holding that while North River's notice of claim was late, the reinsurer suffered no prejudice. The *Unigard* court did not elaborate upon what might generally constitute prejudice but it suggested that a reinsurer's ability to participate in any settlement, assert a prompt challenge to a settlement, and/or have the opportunity to set reserves might be factors in finding that a reinsurer suffered prejudice.

Several recent decisions by New York courts, applying New York law, have addressed the "account stated" principle. In *American Home Assurance Co v Instituto Nacional de Reaseguros* (*INDR*), N° 88 Civ 0917 (CSH) [SDNY 10 January 1991] (available on WESTLAW at 1991 WL 4461), the court applied the 'account stated' doctrine to the reinsurance context, holding that a reinsurer's lack of protest concerning a statement of account converts the statement into an "account stated." An account stated is an agreement, express or implied, that an examination of the account between the parties has occurred, that a statement of that account has been asserted, and that it has been accepted as correct. See *Navimex SA de CV v S/S Northern Ice,* 617 F Supp 103, 105 (SDNY 1984). Absent a timely objection, the statements will be presumed to be correct by the courts should litigation ensue, and attempts to rebut this presumption could prove quite difficult. As a result, under the *INDR* court's analysis, a reinsurer who fails either to object or inquire on a prompt basis into the statements of account received from its ceding company may find its arsenal of defenses dangerously limited should the reinsurer eventually decide to contest the claims.

The *INDR* court did not define or even further discuss the term 'reasonable'. However, in *Insurance Company of the State of Pennsylvania v Compania Agricola de Seguros SA,* N° 88 Civ6313 (KC) (SDNY December 19, 1989), aff'd No 90–7118 (2d Cir 3 May 1990) the court held that a reinsurer's three-year delay in questioning invoices it had been receiving from its ceding carrier was unreasonable. Under the reasoning of *INDR* and *Compania Agricola*, where a reinsurer fails to object in a "timely" or "reasonable" manner, it will have difficulty successfully denying the claims unless it can prove fraud or mistake. For instance, once a failure to object gives rise to an "account stated", a debtor who failed to protest during the relationship could no longer contest the accounting method which was used. And, even if the debtor succeeded in showing a factual mistake, this would only result in an adjustment of the account and would not bar the entire claim.

Furthermore, in *Compania Agricola*, the court hold that in litigation ensuing between a ceding company and its reinsurer to which the ceding company had submitted uncontested claims, the ceding company's motion for summary judgment should be granted unless "there has been some sort of specific challenge or objection to the accounts, whether oral or written, prior to the litigation, which defendant can articulate with particularity."

In sum, the American courts have become increasingly active in resolving reinsurance disputes, and companies doing business with carriers domiciled in the USA would be well advised to keep current on the developing case law. ■

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