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Insurance Practice

Reinsurance Redux

The redux on developments in the law of reinsurance

In This Issue

Illinois District Court Finds Revenue-Sharing Agreement Between Reinsurer and Broker to be Ambiguous

Homeowners Choice Inc. v. Aon Benfield Inc., No. 19-7700 (N.D. Ill. Sept. 10, 2012).

On September 10, 2012, a Northern District of Illinois judge denied cross-motions for summary judgment filed by a reinsurer and the reinsurance broker in their dispute over the reinsurer's annual fee in a revenue-sharing agreement because the operative language in the agreement was ambiguous.

Homeowners Choice Inc. ("Homeowners Choice") brought suit against its reinsurance broker/intermediary, Aon Benfield Inc. ("Aon"), alleging that Aon owed Homeowners Choice $659,943 under a revenue-sharing agreement. Homeowners Choice Property and Casualty Insurance Company ("Homeowners Insurance"), a subsidiary of Homeowners Choice, entered into an agreement with Aon to procure for it reinsurance policies and designated Aon as its broker of record beginning July 1, 2007. Thereafter, in March 2009, Homeowners Choice and Aon entered into a revenue-sharing agreement providing that in certain situations Aon would pay Homeowners Choice a portion of the commission ("Annual Fee") Aon earned from Homeowners Insurance's reinsurance placements ("Subject Business"). The revenue-sharing agreement provided in relevant part:

> 1. In consideration for [Homeowners Choice] appointing Aon Benfield as reinsurance intermediary-broker for the placement and servicing of all reinsurance purchased by [Homeowners Choice] (the "Subject Business") for the annual period beginning on June 1, 2009 and ending on May 31, 2010 (an "Agreement Year"), [Aon] agrees to share with [Homeowners Choice] [Aon's] received and earned brokerage revenue derived from the Subject Business . . . by paying [Homeowners Choice] an annual fee ("Annual Fee") for the Agreement Year. . .
>
> 2. No Annual Fee shall be . . . payable subsequent to any decision by [Homeowners Choice] to terminate or replace [Aon] as its reinsurance intermediary-broker for any portion of the Subject Business. . . .

A year later, Homeowners Insurance notified Aon that it would be using a different reinsurance broker for placements starting on June 1, 2010. Around this same time, as part of the revenue-sharing agreement, Homeowners Choice notified Aon it was owed an Annual Fee under the agreement for 2009-2010 in the amount of $659,943. Aon refused to remit payment pursuant to Paragraph 2.

The parties filed cross-motions for summary judgment. According to the Court, the crux of the dispute was the meaning of "Subject Business" in the revenue-sharing agreement and how such a reading impacted the Annual Fee. Aon's chief argument was that "Subject Business" referred to all of Homeowners Choice's reinsurance contracts, including those after the "Agreement Year," but because Aon was switched as the broker for Agreement Year 2010-2011, it was excused from paying the Annual Fee under Paragraph 2. Aon also argued that the plain language of Paragraph 2 created an express condition on Aon's obligation to pay the Annual Fee.

Conversely, Homeowners Choice argued, among other things, that "Subject Business" is limited to the defined "Agreement Year," and because Homeowners Insurance did not terminate Aon in connection with the 2009-2010 reinsurance placements, it was entitled to the Annual Fee for that year. Homeowners Choice also argued that, given Homeowners Insurance had an "undisputed unfettered" right to appoint a new broker at any time, Aon's construction of Paragraph 2 constituted an unenforceable penalty clause and violated Illinois law.

In denying both parties' cross-motions, the Court determined, among other things, that the revenue-sharing agreement was ambiguous (despite the parties' claim that it was unambiguous) as to the definition of "Subject Business," and therefore a question of fact remained as to whether Aon owed the 2009-2010 Annual Fee. According to the Court, while the "definitions" section of the revenue-sharing agreement supported Aon's position, the remaining provisions rendered "Subject

Business" ambiguous. Indeed, the Court stated, "both parties have reasonable arguments that their definition of 'Subject Business' . . . reflects the parties' intent." With this backdrop, the Court also determined that Paragraph 2 regarding the Annual Fee was equally ambiguous. Further, while the Court agreed with Aon that Paragraph 2 created an express condition on Aon's obligation to pay the Annual Fee, it determined it was not a penalty clause nor was it violative of Illinois law under the current record.

REDUX IN CONTEXT:

- Contract interpretation, including reinsurance contracts, remains within the providence of the court, and, even where the parties agree that a provision is unambiguous, the court may still conclude otherwise.

Northern District of Illinois Upholds "Follow the Settlements" Clause of Reinsurance Treaty and Orders Reinsurer to Pay Underlying Settlement

Arrowood Indemnity Co., et al. v. Assurecare Corp., No. 11-cv-05206 (N.D. Ill. Sept. 19, 2012).

Upholding a reinsurance treaty's "follow the settlements" clause and its application to the settlement of an underlying insurance dispute, on September 19, 2012, the Northern District of Illinois granted summary judgment in favor of an insurer and ordered its reinsurer to pay the underlying settlement.

Arrowood Indemnity Co., successor to Landmark American Insurance Co. and Arrowood Surplus Lines Insurance Co., formerly Royal Surplus Lines Insurance Co. (collectively, "Arrowood") claimed that Assurecare Corp., formerly Assurecare Risk Retention Group ("Assurecare"), provided Arrowood with 100% quota-share reinsurance covering December 1, 2001 through April 1, 2003. Specifically, Assurecare was responsible for the first $250,000 of Arrowood's net liability as well as a percentage share of loss adjustment expenses in connection with – in this case – a liability insurance policy issued to FHC Enterprises, Inc., which insured Greenwood Terrace Nursing and Rehab Center, LLC. The parties' treaty also allowed Arrowood to utilize letters of credit provided by Assurecare to reimburse Arrowood for Assurecare's obligations.

In 2002, Greenwood Terrace was sued following the death of one of its residents/patients, the suit ultimately ending in a $1.75 million settlement. Arrowood subsequently paid $1 million on the settlement, the "medical incident" limit on its policy. Assurecare subsequently tendered payment for the billed amount.

Thereafter, Greenwood Terrace filed its own breach of contract action against Arrowood alleging, among other things, that Arrowood should have paid a greater proportion of the settlement because there had been more than one "medical incident" involved in the underlying suit. Arrowood disputed the claim that multiple medical incidents occurred, but nonetheless settled this suit for $325,000. Arrowood then billed Assurecare for its share of the Greenwood Terrace settlement, including the obligation for the first $250,000 of net liability and a proportion of loss adjustment expense. Assurecare contested its obligation and refused to pay the billed amount. Arrowood drew on a letter of credit in the amount of $361,518 in partial satisfaction of the Greenwood Terrace claim.

Subsequently, Arrowood filed suit against Assurecare, alleging breach of contract for failing to pay the remaining sum of $230,527.76 due in the Greenwood Terrace claim.

Additionally, having drawn down the letter of credit, Arrowood alleged a collateral shortfall under the terms of the treaty and sought an order requiring renewed collateralization. Assurecare counterclaimed, seeking, among other things, declaratory judgment that the reinsurance treaty did not apply to any losses or liability incurred by Arrowood resulting from the Greenwood Terrace lawsuit.

Arrowood filed a motion for summary judgment, its chief contention being that two provisions of the treaty support the argument that the Greenwood Terrace settlement was covered under the reinsurance treaty: 1) the settlement monies constitute a "loss settlement," defined in the treaty as "individual payments made by the Company in accordance with its Obligations under the subject Policies;" and 2) the treaty's "follow-the-settlements" clause, which provided that all "loss settlements made by the Company" by way of compromise "shall be binding upon Reinsurer . . . ." Arrowood also contended that Assurecare was responsible for proportional share of loss adjustment expenses and, having drawn down the letter of credit, sought an order requiring renewed collateralization. Assurecare, on the other hand, contended that the settlement did not fall within the scope of the Greenwood Terrace policy, and was therefore not a loss payment subject to the "follow-the-settlements" clause.

Focusing principally on the treaty's "follow-the-settlements" clause, the Court granted Arrowood's motion for summary judgment. The Court reasoned that absent a showing of bad faith, collusion or fraud on Arrowood's part in entering into the settlement – of which there was no evidence in this case – Arrowood's decision to settle a claim regarding a coverage dispute may not be second-guessed by its reinsurer under the treaty's unambiguous "follow-the-settlements" clause. Accordingly, the Court also held that Arrowood was entitled to lost adjustment expenses and ordered Assurecare to fund the collateral shortfall under its letter of credit.

REDUX IN CONTEXT

- Courts will interpret reinsurance agreements according to their express terms; and
- In Illinois, absent a showing of bad faith, collusion or fraud, an insurer's decision to settle a claim regarding a coverage dispute may not be second-guessed by its reinsurer under a treaty's unambiguous "follow-the-settlements" clause.

Southern District of New York Confirms Arbitration Award and Holds Arbitration Panel's Refusal to Hear Certain Evidence Did Not Limit Reinsurer's Right to a Fair Hearing

Century Indemnity Co., et al. v. AXA Belgium, No. 11-cv-07263, 2012 WL 4354816 (S.D.N.Y. Sept. 24, 2012).

The Southern District of New York recently granted a group of insurers' petition to confirm a series of arbitration awards and denied a reinsurer's cross-petition to vacate the awards holding an arbitration panel's refusal to hear certain evidence did not limit the reinsurer's right to a full and fair hearing.

In this case, petitioners were Century Indemnity Company, ACE INA Insurance Company, and ACE Property and Casualty Company (collectively, "ACE"), and the respondent was reinsurer AXA Belgium ("AXA"). This case involves four reinsurance contracts, all of which contained binding arbitration clauses. Under two of the contracts, Treaty 3083 and Treaty 1001, AXA's predecessor, Royale Beige Incendie Reassurance, provided reinsurance to ACE's predecessors and affiliates. Under the third contract, the Managing General Agency Agreement ("MGA"), Royale Beige authorized another former affiliate of ACE to write insurance and reinsurance on its behalf. This affiliate procured reinsurance on Royale Beige's behalf from a predecessor of ACE, pursuant to the fourth relevant contract, the Quota Share Reinsurance Agreement

("QSRA"). Through subsequent mergers of the various parties to these four treaty agreements, the end result was ACE and AXA had overlapping liability to one another for certain reinsurance and insurance obligations (that could be offset against one another under the treaty agreements).

For several years, ACE attempted to collect overdue balances from AXA under the agreements, including amounts due under a prior 2007 arbitration award in connection with Treaty 1001. In 2009, following continued disputes over payments, ACE commenced arbitration proceedings in connection with Treaty 3083 and Treaty 1001 and sought reinsurance payments they claim were owed, security to ensure future payments, and a declaration rejecting their liability to AXA for offsetting reinsurance claims pursuant to the QSRA. AXA responded with counter-arbitration demands for the initiation of two new arbitrations: in one, claiming payment under the MGA and QSRA, and in the other, payment under Treaty 1001. AXA also disputed liability to ACE and asserted it was entitled to offset any amounts due from ACE pursuant to the QSRA.

The four arbitrations were ultimately consolidated. Following a nine-day hearing, the arbitration panel issued two interlocutory awards in February and March 2011. In award two, which was the only award substantively challenged by AXA in this case, the panel ruled in favor of ACE that it had no liability under the QSRA and ordered AXA to make a number of payments to ACE, including certain of ACE's attorney's fees. The panel retained jurisdiction for nine months following issuance of the award, during which it indicated it would entertain, among other things, any requested modifications to the award. At this time, AXA submitted a petition to modify the award, arguing neither the parties nor the panel identified the governing law of a specific jurisdiction for the dispute, and in connection therewith sought to introduce new evidence and testimony with respect to certain issues related to the QSRA. In October 2011, without a hearing, the panel denied AXA's petition to modify and made the two awards final.

In October 2011, ACE petitioned the Court to confirm the awards. AXA cross-petitioned to vacate the awards, asserting, among other things, that the panel: 1) was guilty of misconduct in refusing to hear additional evidence, 2) exceeded its powers by rewriting the agreements between the parties when it imposed punitive attorney's fees, and 3) acted in "manifest disregard of the law" by failing to apply Belgian law.

The Court denied AXA's petition. First, reasoning that arbitrators "enjoy broad discretion to decide whether to hear certain evidence," the Court held that there was no merit to the claim that the arbitration panel refused to hear pertinent evidence and denied AXA a full and fair hearing. Second, the Court determined that the panel did not rewrite the agreements between the parties, but simply agreed with ACE's interpretation rather than AXA's and the panel was within its authority to award attorney's fees due to AXA's dishonorable conduct. Third, the Court determined that the panel did not act in "manifest disregard of the law" by failing to apply Belgian law. In fact, AXA did not raise the issue of Belgian law in its briefing before the arbitration hearing or at the hearing itself, and in fact only raised the issue five months after the interlocutory awards (and even then, did not actually assert that Belgian law governed). Therefore, according to the Court, it cannot be said that the issue of the question of law that was allegedly ignored by the panel "was clear, and in fact explicitly applicable to the matter before the arbitrators."

REDUX IN CONTEXT

- An arbitration award will only be disturbed in extraordinary circumstances;
- The Court will uphold an arbitration panel's authority to award attorney's fees when confronted with bad faith conduct;
- "Manifest disregard of the law" continues to be a high standard for overturning an arbitration award; and
- Courts generally will not permit parties to an arbitration agreement to circumvent the terms of such agreement through judicial intervention.

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