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Insurance Practice

Reinsurance Redux

The redux on developments in the law of reinsurance

In This Issue

District of New Jersey Stays Medical Malpractice Suit Pending Arbitration

New Jersey Physicians United Reciprocal Exchange d/b/a NJ Pure v. Ace Underwriting Agencies, Ltd., et al., No. 12-04397, 2013 WL 1558716 (D.N.J. April 11, 2013).

Finding that a dispute between a medical malpractice insurer and a reinsurance underwriter fell squarely within the plain meaning of the arbitration clause in a reinsurance agreement and that a service of suit clause did not serve as an exception allowing the insurer to litigate its claims, the United States District Court for the District of New Jersey recently remanded a lawsuit to arbitration.

Plaintiff New Jersey Physicians United Reciprocal Exchange ("NJ Pure") and a group of Defendant reinsurers ("Defendants") entered into a First Excess of Loss Reinsurance Contract, effective January 1, 2004 to January 1, 2007 (the "2004 contract"), under which Defendants agreed to reinsure a portion of NJ Pure's liabilities under medical professional liability policies issued by NJ Pure. The premium paid to the participating reinsurers was subject to annual adjustments and Defendants claimed that they were entitled to an additional adjustment premium of $1,894,076, an amount NJ Pure disputed. Subsequently, NJ Pure and Defendants entered into another First Excess of Loss Reinsurance Contract, effective January 1, 2007 to December 31, 2009 (the "2007 contract"), under which NJ Pure contended that Defendants owed it $2,117,704 arising from losses and premium adjustments. Defendants did not dispute this claim, but instead argued that they should be permitted to offset the amount they owed under the 2007 contract with the amount they alleged was owed to them under the 2004 contract pursuant to an "offset provision" in the 2007 contract.

NJ Pure filed suit in 2012 in the District of New Jersey claiming that Defendants breached the 2007 contract under which Defendants owed NJ Pure $2,309,431. Specifically, NJ Pure contended that Defendants improperly offset $1,894,076 from the amount they owed NJ Pure under the 2007 contract, which represented an amount allegedly owed to Defendants by Plaintiff under the 2004 contract, and sought a declaratory judgment that such an offset was in violation of the 2007 contract. Defendants moved to dismiss the complaint or stay the litigation on the ground that Plaintiff's claims were subject to arbitration pursuant to the arbitration clause in the 2007 contract and the Federal Arbitration Act, 9 U.S.C. § 3.

Thereafter, Defendants initiated arbitration seeking to arbitrate 1) the disputed premium adjustment under the 2004 contract, and 2) the offset issue under the 2007 contract. NJ Pure agreed to arbitrate the first issue, which is currently pending in arbitration, but refused to arbitrate the second. Defendants argued that any dispute as to whether the offset provision is permissible is subject to the broad arbitration clause set forth in the 2007 contract that provides "all disputes of differences arising out of or connected with this Contract . . . shall, upon the written request of either party, be submitted to three arbitrators[.]" NJ Pure countered that the alleged amounts owed to it and any amounts it owed to Defendants arose under two different contracts, and therefore the offset was impermissible pursuant to the offset clause. Plaintiff also argued that in cases such as this, where money is claimed to be due, the "service of suit" clause allows it to file suit rather than submit to arbitration "in the event of the failure of the Reinsurers hereon to pay any amount claimed to be due . . . ."

In granting Defendants' motion to compel arbitration, the Court ruled that the dispute fell under the plain meaning of the arbitration clause and the service of suit clause did not serve as an exception allowing NJ Pure to litigate its claims.

On the first issue, the Court reasoned that virtually all of NJ Pure's claims and arguments relate to its interpretation of the contract, and therefore the dispute clearly falls under the arbitration clause because it applies to "all disputes or differences arising out of or connected" to the contract. According to the Court, while it was true that the amount due under the 2007 contract was not disputed, what was disputed was whether that amount could be offset by the amount allegedly owed to

Defendants under the 2004 contract, a dispute that was certainly one connected with the contract.

On the second issue, relying on precedent from the Third Circuit and other federal courts of appeal, the Court held that the arbitration clause was enforceable despite the presence of the service of suit clause. According to the Court, the two provisions could be read in harmony. Under the contract, if neither party would request arbitration of a certain dispute (which did not happen in this case), the service of suit clause would then come into play to determine the jurisdiction under which such dispute would be litigated, akin to a forum selection clause. Moreover, according to the Court, even if it were to find that NJ Pure's claim for payment was subject to litigation pursuant to the service of suit clause, such a claim was "inextricably intertwined" with the offset dispute, which was plainly the subject of arbitration.

Redux in Context:

- Courts will generally enforce broadly drafted arbitration provisions covering "all disputes or differences arising out of or connected" to a contract even if such disputes involve other contracts.
- Federal courts have consistently found arbitration clauses to be enforceable in contracts that also contain a service of suit clause.

District of Connecticut Grants Reinsurer's Motion to Compel Discovery Regarding Factual Issues Surrounding Insurer's Post-Settlement Allocation Decision Despite Presence of "Follow the Settlements" Clause

Travelers Indemnity Co. v. Excalibur Reinsurance Corp., No. 3:11-CV-1209, 2013 WL 1409889 (D. Conn. April 8, 2013).

In granting two motions to compel, the United States District Court for the District of Connecticut recently held that under New York law, a reinsurer is entitled to discovery in connection with its challenge of the reasonableness of an insurer's post-settlement allocation decision and other related factual issues despite the presence of a "follow the settlements" clause in the reinsurance treaty.

Plaintiff The Travelers Indemnity Co. ("Travelers") issued four annual errors and omissions policies to its insured, an unnamed broker, with periods running from 1997 to 2001. In conjunction therewith, Travelers took out partial reinsurance coverage with a number of reinsurers, one of them being Defendant Excalibur Reinsurance Corp. ("Excalibur"). Excalibur participated in Travelers' reinsurance program only in the second, third and fourth years of the four underlying policy periods. Accordingly, Excalibur objected when Travelers, in a negotiation with its insured, allocated the underlying losses only to the second and third policy periods, and called upon Excalibur to pay its share of the reinsurance. Excalibur challenged the fairness and accuracy of that allocation and refused to pay under the reinsurance contracts and treaty, prompting Travelers to file suit.

It was Travelers' position that under the follow the settlements clause in its reinsurance contracts with Excalibur, Excalibur was bound by the allocation of settlement payments among the reinsurers made by Travelers. In other words, according to Travelers, Excalibur was forbidden as a matter of law from second-guessing Travelers' claim decisions provided that those decisions were not made fraudulently or in bad faith, and that the claims paid were at least arguably within the coverage of the insurer's policy.

Excalibur contended that since the E&O policies issued to the broker were claims-made policies – where the policy is limited to indemnity for only those claims that are first made against the insured during the policy period – and Excalibur did not participate as a reinsurer during all the years of the reinsurance program, its obligation to contribute to a particular loss

depends upon which year the underlying claim was asserted. In Excalibur's view, the follow the settlements clause, when properly construed, would not bar Excalibur from arguing that Traveler's allocation was unreasonable, or that the underlying claims Travelers settled were not covered by the reinsurance contract between Travelers and Excalibur.

Excalibur sought discovery in aid of these contentions, including the dates when the underlying claims were first asserted. Traveler's objected, arguing that Excalibur's discovery requests were relevant only to Excalibur's challenges to Travelers' allocation among reinsurers of the underlying losses occasioned by the insured Broker's conduct, and since the follow the settlements doctrine precludes Excalibur from challenging that allocation (or even questioning or inquiring into it in Traveler's view), the requested documents and information were not subject to discovery.

The Court granted Excalibur's two motions to compel discovery. The Court reasoned that under New York law, while the follow the settlements doctrine extends to a cedent's post-settlement allocation decision regardless of whether an inquiry would reveal an inconsistency between that allocation and the cedent's pre-settlement assessment of risk, that decision must be made in good faith, be reasonable, and be within the policy limits. Because Excalibur is permitted to challenge the reasonableness of Travelers' post-settlement allocation decision and to argue that the economic consequence of that allocation violated or disregarded provisions in the reinsurance contract despite the presence of the follow the settlements provision, Excalibur is entitled to discovery on these issues.

Redux in Context:

- Under New York law, while the follow the settlements doctrine extends to a cedent's post-settlement allocation decision regardless of whether an inquiry would reveal an inconsistency between that allocation and the cedent's pre-settlement assessment of risk, that decision must be made in good faith, be reasonable, and be within the policy limits.
- Under New York law, a reinsurer is entitled to discovery in connection with its challenge of the reasonableness of an insurer's post-settlement allocation decision and other related factual issues despite the presence of a "follow the settlements" clause in the reinsurance treaty.

On Reconsideration, District of New Jersey Finds That Reinsurer Cannot Prove Prejudice for Purposes of Late Notice Defense, But That Question of Law Exists Regarding Adequacy of Reporting Under Sunset Provision

Munich Reinsurance America, Inc. v. American National Insurance Co., — F. Supp. 2d — , 2013 WL 1314730 (D.N.J. Mar. 28, 2013).

On a motion for reconsideration, the United States District Court for the District of New Jersey amended its prior grant of summary judgment in favor of the plaintiff cedent on the defendant reinsurer's late notice defense (which decision was discussed here in *Reinsurance Redux* – October 2012 http://www.saul.com/media/site_files/3345_Redux102312.pdf), holding that the reinsurer could not prove prejudice as a matter of law, but that a genuine issue of material fact remained as to the adequacy of the cedent's claims reporting for purposes of a sunset provision that was a condition precedent to the reinsurer's indemnity obligations under the retrocession contracts at issue.

Munich Reinsurance America, Inc. ("Munich Re") and American National Insurance Company ("ANICO") entered into separate retrocession contracts, one for the period from

November 1, 2000 through December 31, 2000 (the "2000 Contract") and one for the period from January 1, 2001 to December 31, 2001 (the "2001 Contract"). The retrocession contracts contained identical notice provisions requiring prompt notice of all claims and immediate notice of certain categories of claims. The retrocession contracts also contained identical commutation provisions which included a "sunset" clause providing that no liability shall attach for any claims not reported within seven years of the expiration of the contract – the "sunset" period. Prior to the expiration of the sunset period for the 2001 Contract, Munich Re provided ANICO, through its managing general agent, with a summary listing of all claims under the retrocession contracts. However, Munich Re did not provide individual notice of certain claims under the retrocession contracts during the sunset period.

The Court had previously held that the notice provisions in the retrocession contracts were not a condition precedent, and that under New York law ANICO must prove prejudice in order to prevail on a late notice defense. ANICO's sole evidence of prejudice was the affidavit of one of its senior employees who claimed that ANICO would not have commuted its own retrocession treaty with Max Re, Ltd. if it had received timely notice of claims and that ANICO would have therefore received a greater economic benefit. On summary judgment, the Court disregarded the affidavit under the sham affidavit doctrine and held that ANICO could not prove prejudice as a matter of law. However, the Court did not specifically address whether the sunset provision was a condition precedent to payment.

On reconsideration, the Court affirmed its prior decision that ANICO could not prove "tangible economic injury" in order to establish prejudice for purposes of a late notice defense under the notice provisions of the retrocession contracts. The Courts looked at the merits of the ANICO affidavit, which stated that the terms of ANICO's retrocession treaty with Max Re, Ltd. were different than the terms set forth in the cover slip. The cover slip provided a commutation formula where ANICO simply received a return of premiums paid to Max Re, less a commission and the amount of claims paid. Under this commutation formula, the commutation amount could not be impacted by late reporting of claims and ANICO could not have derived any greater economic benefit by deciding not to commute. The ANICO affidavit alleged that a different agreement was signed which contradicted those terms, but ANICO was not able to locate a copy of this "phantom" agreement or any record of its existence. The Court held that ANICO could not prove prejudice as a matter of law because no reasonable factfinder could credit the testimony regarding the "phantom" agreement, and that testimony would be inadmissible at trial under the best evidence rule.

However, the Court further held that the sunset provision in the retrocession contracts, unlike the notice provisions, created a condition precedent, such that ANICO did not need to prove prejudice if Munich Re failed to provide notice of claims within seven years under the sunset provision. Munich Re admitted that certain claims were not individually reported prior to the expiration of the respective sunset periods, but argued that an errors and omissions clause in the retrocession contracts excused this failure and that ANICO nonetheless had notice of some of the claims by virtue of a spreadsheet listing all claims under the retrocession contracts that was provided to ANICO's managing general agent on August 8, 2008.

The Court rejected Munich Re's argument that an errors and omissions clause excused its failure to report certain claims within the sunset period and granted summary judgment to ANICO with respect to claims under the 2000 Contract that were not individually reported prior to the expiration of the sunset period. With respect to claims under the 2001 Contract, however, the Court examined whether bordereau-style reporting similar to the August 8, 2008 spreadsheet provided adequate notice for purposes of the sunset provision.

There was conflicting evidence and expert testimony regarding the notice required by the sunset provision and whether the spreadsheet provided adequate notice, as ANICO argued that the spreadsheet provided insufficient detail and was overinclusive to the extent it failed to identify the claims likely to breach ANICO's layer. Munich Re contended that the sunset provision did not require the same form of notice as the notice provision and that the spreadsheet provided to ANICO was consistent with industry custom and practice. The Court further found that there was no extrinsic evidence of the parties' intent with respect to the notice required by the sunset provi-

sion. Accordingly, it held that a genuine issue of fact exists "as to whether Munich's prior practice of individual claim reporting under [the notice provision] should be determinative of what type of reporting the parties intended with respect to [the sunset provision]" and "as to the type of notice contemplated by [the sunset provision]."

Redux in Context:

- Under New York law, a reinsurer must prove prejudice in the form of "tangible economic injury" to prevail on a late notice defense, unless timely notice is a condition precedent to payment.
- Under New York law, a sunset provision in a reinsurance contract providing that "no liability shall attach" for claims that are not reported within the sunset period creates a condition precedent to payment, such that a reinsurer need not prove prejudice to avoid its indemnity obligations, even where the applicable notice provision does not make timely notice a condition precedent.
- Under New York law, bordereau-style reporting may not serve as adequate notice for purposes of sunset reporting where the sunset provision in the reinsurance contract does not specifically provide for that type of reporting.

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