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Contacts:
Amy S. Kline
215.972.8567
akline@saul.com
Sean T. O'Neill
215.972.7159
soneill@saul.com
Braden A. Borger
215.972.7176
bborger@saul.com
Matthew J. Smith
215.972.7535
msmith@saul.com
Brian P. Simons
215.972.7194
bsimons@saul.com
Patrick F. Nugent
215.972.7134
pnugent@saul.com

Saul Ewing LLP

Insurance Practice

Reinsurance Redux

The redux on developments in the law of reinsurance

In This Issue

Southern District of New York Predicts That California Would Adopt Bad Faith Exception to Requirement That a Reinsurer Prove Prejudice for Late Notice Defense

Insurance Co. of the State of Pennsylvania v. Argonaut Insurance Co., No. 12 Civ. 6494(DLC), 2013 WL 4005109 (S.D.N.Y. Aug. 6, 2013).

On August 6, 2013, the United States District Court for the Southern District of New York granted in part a reinsurer's motion for summary judgment on its late notice defense, holding that the cedent failed to provide timely notice as a matter of law. However, the court concluded that there were genuine issues of fact to be resolved at trial regarding whether the reinsurer was actually prejudiced by the late notice and whether the reinsurer was excused from proving prejudice due to the cedent's gross negligence or bad faith in its claims handling.

Argonaut Insurance Company ("Argonaut") agreed to issue a facultative certificate to Insurance Company of the State of Pennsylvania ("ICSOP") to reinsure a portion of an excess insurance policy that ICSOP issued. The facultative certificate required prompt notice of any loss that might implicate the reinsurance and granted Argonaut the right to associate in the defense and control of any claim. Argonaut ceded some of the risk it had underwritten in the facultative certificate to a number of retrocessionaires pursuant to a Special Participating Excess Reinsurance Agreement ("Retrocession Treaty").

In 1988, ICSOP was told to expect asbestos claims under the excess policy reinsured by Argonaut, and by 1996 ICSOP had received notice of such a claim under the policy. In 2001, ICSOP was notified by the primary insurer that its limits were exhausted. The following year, ICSOP was named as a defendant in a declaratory judgment action involving its excess coverage. However, ICSOP did not provide notice to Argonaut until 2009. Between 2001 and 2009, Argonaut entered into several commutation agreements with retrocessionaires participating in the Retrocession Treaty.

ICSOP sued Argonaut to enforce the terms of the facultative certificate and Argonaut raised a late notice defense. The court applied a choice of law analysis and concluded that California law would apply to the extent there was any conflict between New York and California law. The court further concluded that ICSOP's obligation to provide notice to Argonaut arose in 2002 at the latest, when ICSOP was named in the declaratory judgment action for excess coverage. Because ICSOP did not provide notice until 2009, the court held that it breached the notice provision in the facultative certificate as a matter of law.

The court next turned to the question of prejudice, noting that both New York and California require a reinsurer to demonstrate prejudice to avoid its indemnity obligations due to late notice. Likewise, the loss of the right to associate is insufficient on its own to constitute prejudice under the laws of both states. Instead, the reinsurer must show that the results of the litigation would have been different. Argonaut claimed that it was prejudiced by ICSOP's late notice because (1) it could have obtained a more favorable settlement of the declaratory judgment action and (2) it would have received more in its commutations. The court held that these were triable issues of fact.

The court further held that Argonaut would be relieved of its burden to prove prejudice if it instead demonstrated that ICSOP acted in bad faith by failing to provide timely notice. In doing so, the court predicted that California would adopt the bad faith exception recognized under New York law as set forth in *Unigard*. In *Unigard*, the Second Circuit held that if a cedent deliberately deceives a reinsurer or fails to implement routine practices and controls to ensure timely notice, then the reinsurer need not prove prejudice to succeed on a late notice defense. The court predicted that California would adopt this exception to the prejudice requirement because it is premised on the same duty of utmost good faith recognized by New York and California and because California courts recognize that reinsureds are sophisticated parties familiar with notice practices, such that the requirement to implement routine prac-

tices is minimally burdensome and consistent with the expectations of the parties to a reinsurance contract. Accordingly, the court allowed further discovery regarding ICSOP's bad faith claims handling.

Redux in Context:

- Under New York and California law, a reinsurer is required to prove prejudice in order to succeed on a late notice defense.
- Under New York and California law, the mere loss of the right to associate in the defense of a claim is not sufficient to establish prejudice, unless the results of the litigation would have been different.
- New York recognizes a bad faith exception to the requirement that a reinsurer prove prejudice; California is predicted to adopt the same exception due to the similarities between New York and California law on reinsurance.

District Court Refuses to Compel Separate Arbitrations Arising From Separate Reinsurance Contracts

Granite State Insurance Co. v. Clearwater Insurance Co., No. C 13-2924 SI, 2013 WL 4482948 (N.D. Cal. Aug. 19, 2013).

On August 19, 2013, the United States District Court for the Northern District of California ordered the parties to select an umpire in accordance with their reinsurance contract rather than having one appointed by the court. The district court also refused to compel separate arbitrations for disputes arising out of additional contracts between the parties because such a consolidation issue was a question for the arbitrators.

Granite State Insurance Company ("Granite State") and Clearwater Insurance Company ("Clearwater") were parties to two separate reinsurance agreements. New Hampshire Insurance Company ("NHIC") and Clearwater were also parties to a reinsurance agreement. Clearwater was the reinsurer under each contract. Granite State and NHIC are both in the American International Group, Inc. of insurance companies. In 2006, Granite State and NHIC entered into a settlement covering thousands of asbestos claims, and then billed Clearwater for its share of the settlement payments pursuant to the three reinsurance contracts. After paying some of these bills, Clearwater stopped making payments and Granite State and NHIC made a single demand for arbitration.

The reinsurance contracts contained identical arbitration provisions requiring each party to select an arbitrator with an umpire selected by the two arbitrators. If the arbitrators cannot agree on an umpire, each arbitrator submits two names, the parties each strike one name from the other party's umpire list, and then draw lots from the remaining two candidates. Granite State and NHIC selected a single arbitrator. Clearwater contended that separate arbitrations were required and selected one arbitrator for the two contracts with Granite State and another arbitrator for the contract with NHIC. The Granite State/NHIC arbitrator and one of the Clearwater arbitrators eventually submitted two names each for an umpire. Clearwater offered to proceed with a single arbitration if the parties agreed which "honorable engagement" clause would govern the proceedings. Granite State and NHIC filed a petition with the district court to appoint an umpire in a single arbitration proceeding. Clearwater cross-petitioned to compel three separate arbitrations.

The court refused to grant either petition because "disputes as to the scope of the parties' agreement to arbitrate is for the arbitrator, not the Court." The district court noted that numerous courts have held that the question of whether arbitration should proceed in one or multiple proceedings is for the arbitrators to decide and therefore concluded that the question of whether Granite State/NHIC's demand for a single arbitration was improper is outside the court's authority to review arbitration agreements.

The district court held that its authority was limited to either requiring the parties to arbitrate as agreed or to appoint arbitrators under impasse conditions. Accordingly, it could not

interpret the reinsurance contracts to determine whether they required one or more arbitrations. Moreover, since only one demand for arbitration was made, the court could not compel two additional arbitrations where no demand was made.

The district court likewise refused to appoint an umpire because it was not impossible to comply with the selection method provided for in the reinsurance contracts. In the Ninth Circuit, courts are to require compliance with umpire selection provisions whenever possible. Accordingly, the district court ordered the parties to select an umpire by each striking one name from the other side's list and then drawing lots. Once the umpire is selected, the single arbitration panel can decide whether Granite State/NHIC's demand for arbitration was proper and which "honorable engagement" provision should govern.

Redux in Context:

- Questions regarding the scope of an agreement to arbitrate – including whether one or multiple arbitration proceedings are required – are for arbitrators to decide.
- Courts cannot compel multiple arbitrations under separate reinsurance contracts where only a single arbitration demand has been made.
- In the Ninth Circuit, courts will require compliance with the umpire selection provision of a contract instead of appointing an umpire unless compliance with the umpire selection provision is impossible.

District Court Holds That Certain Demands For Payment To Retrocessionaires Were Barred By The Statute of Limitations

Republic Insurance Co. v. Banco De Seguros Del Estado, No. 10 C 5039, 2013 WL 3874027 (N.D. Ill. July 26, 2013).

On July 26, 2013, the United States District Court for the Northern District of Illinois ordered retrocessionaires to make payment to its retrocedent for certain bills submitted within the six-year statute of limitations under English law. The district court concluded that the retrocession contract created an open account, but that a billing provision in the contract began the running of the six-year statute of limitations.

Republic Insurance Company ("Republic") entered into quota share retrocessional contracts from 1977 to 1980 in which Banco De Seguros Del Estado ("Banco") and Group Des Assurances Nationales ("GAN") participated. The retrocessional contracts required Republic to prepare semi-annual accounts to bill its retrocessionaires for their share of paid claims. From 1993 until 2003, Republic failed to send any bills, but included claims from that 10-year period in subsequent accounts. Defendants refused to pay certain claims and Republic filed suit in 2010. The defendants claimed that certain claims were barred by the statute of limitations, while Republic argued that no claims were barred under an open account theory.

The court concluded that English law applied because the contracts were negotiated and executed in London and the performance of the contracts would be considered to be in London. English law provides a six-year statute of limitations for breach of contract claims. Republic contended that claims included in accounts submitted more than six years before the filing of the lawsuit were not barred because those claims were included in subsequent accounts for which a new cause of action accrued.

The court rejected this argument and held that a party cannot rely on an account stated "unless the party receiving the account confirms or otherwise accepts the statement as valid." Because the defendants never confirmed any of the accounts submitted by Republic, its argument failed as a matter of law.

Applying English law, the court explained how certain claims that should have been billed during the 10-year period when Republic failed to submit semi-annual accounts could have been saved from being time-barred. Republic first sent an account billing for that 10-year period in late 2003. The court held that amounts that should have been included in the June 1997 semi-annual account or any earlier account (i.e., any claim that was more than six years old) that were included in the 2003 account were barred by the statute of limitations. But for any individual amounts included in the 2003 account that were not already time-barred, Republic had an additional six years to file a lawsuit to compel the defendants to pay their share. Because Republic did not file suit until August 2010, all the claims from the 2003 account were time-barred. The district court ultimately concluded that claims based on amounts included in any billing sent more than six years earlier were barred by the statute of limitations, but that the defendants were liable for the amounts billed thereafter.

Redux in Context:

- Under English law, a party cannot rely on an account stated to preclude a statute of limitations defense unless the party receiving the account confirms or otherwise accepts it as valid.
- Under English law, a party has six years to bring a cause of action to compel a reinsurer to pay its share of an account, provided that all the amounts included in the account should not have been billed in an account more than six years earlier.

Baltimore, MD
500 East Pratt St.
Charles O. Monk, II
410.332.8668

Boston, MA
131 Dartmouth St.
Richard D. Gass
617.723.3300

Chesterbrook, PA
1200 Liberty Ridge Dr.
Michael S. Burg
610.251.5750
Nathaniel Metz
610.251.5099

Harrisburg, PA
2 North Second St.
Eric L. Brossman
717.257.7570

Newark, NJ
One Riverfront Plaza
Stephen B. Genzer
973.286.6712

New York, NY
555 Fifth Ave.,
Michael S. Gugig
212.980.7200

Philadelphia, PA
1500 Market St.
Bruce D. Armon
215.972.7985

Pittsburgh, PA
One PPG Place
Charles Kelly
412.209.2532
David R. Berk
412.209.2511

Princeton, NJ
750 College Rd. E
Marc A. Citron
609.452.3105

Washington, DC
1919 Pennsylvania Ave, NW
Mark L. Gruhin
202.342.3444
Andrew F. Palmieri
202.295.6674

Wilmington, DE
222 Delaware Ave.
Wendie C. Stabler
302.421.6865
William E. Manning
302.421.6868