ARIAS U.S.

QUARTERLY

Another View: Should Follow-the-Settlements/Fortunes Be Implied Into Reinsurance Contracts?

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Intertwined Worlds of Insurance, Reinsurance, and the Law in the U.S. and U.K.

What's Going on With Bad Faith?

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BOARD OF DIRECTORS

Celebrations Underway for ARIAS·U.S.' 30th Anniversary

Dear ARIAS Members,

Thirty years ago, industry leaders founded ARIAS·US with the goal of providing the (re)insurance industry with a dispute resolution model that could resolve its most complex disputes in a judicious and efficient manner.

While not every arbitration has met these aspirations, the sheer number of arbitrations that have touched ARIAS over the past three decades is a testament to the vitality of our organization. On behalf of our Board of Directors and Executive Committee, we are thrilled to share our 30th anniversary year with you!

Below are some of the things that we will be focusing on this year.

Membership Model Changes allow for greater participation

First, we have recently changed our membership model to allow our corporate members and Certified Arbitrators to attend non-conference educational events at a minimal cost.

We are looking forward to seeing you at these events, including:

- The 2024 March Educational Workshop in Philadelphia focused on Bankruptcy, Insolvencies and (Re)Insurance
- Arbitrator workshops preceding the Spring and Fall Conferences
- Four scheduled Webinars held over the course of the year.

If you are not a corporate member or a Certified Arbitrator but still hold an individual membership, please consider speaking to Larry Schiffer about upgrading your membership to take advantage of these benefits.

30th Anniversary Celebrations at upcoming conferences

Second, we will be celebrating our 30th anniversary at our centerpiece events – namely our Spring Conference in Puerto Rico and our Fall Conference in New York City.

Please stay tuned for exciting news about our Spring Conference anniversary celebration and remember to book your flights soon to take advantage of inexpensive rates.

Enhancing our mission

Third, along with our 30th Anniversary celebration, our thematic focus for this year is to continue to develop our core mission of enhancing reinsurance arbitration while also looking to build new dispute models, particularly in the direct insurance space. We already have some exciting initiatives in the works currently working their way through the Strategic Planning and other committees, which will be discussed in greater detail at the Spring and Fall conferences.

Improve the arbitrator's experience

Finally, on the back of our successful 2023 "Year of the Arbitrator" theme, our Board is committed to looking for ways to make sure more of our arbitrators are utilized more.

A healthy ARIAS depends on a healthy arbitrator roster. As an organization, we will be working to gain a better understanding of how to retain our arbitrator members and enhance their experience with our organization. We look forward to an active discussion with our membership on these and other issues.

Happy 30th Anniversary!

Marc Abrams
ARIAS Chairperson

Welcome to 2024 and the ARIAS·U.S. 30th Anniversary year! We will be kicking off the 30th Anniversary at the 2024 Spring Conference with a Gala Celebration. Please plan to attend the Spring Conference so you can be a part of the festivities. You won't want to miss it.

Speaking of the Spring Conference, hopefully, by the time you read this, the registration information, including the hotel block, will be available. We are hosting this event at the famous Fairmont El San Juan Hotel in Puerto Rico May 1-3, 2024. The co-chairs — Josh Schwartz, Neal Moglin, Jane Mandigo and Cia Moss — are planning an exciting program with an international flair! Don't wait to make your airline reservations and register today.

Before getting to the Quarterly, I wanted to address several administrative issues. First, membership renewals. The grace period for renewal expired on January 31, 2024. That means if you have not renewed, you are no longer a member and, if you are a certified professional, your certification has now expired. Please contact me or send an email to info@arias-us.org if you need help renewing. If you are a key contact for a corporate member (Law Firm, Insurance or Reinsurance Company, Actuarial or Consulting Company) and you need to update your roster, please contact me.

Second, we have finally obtained access to the ARIAS banking information so we should be able to post checks and ACH/wire transfers for dues and other payments in a timelier manner. We appreciate your patience in receiving renewal notices when you have already sent in your payment. Hopefully, we will now be able to avoid the payment-posting delays we've had in the past.

Third, for 2024, the Enhanced Membership Benefits program provides Certified Arbitrators with a deep discount on all educational programs (excluding the Spring and

Fall Conference) and up to 10 employees of Corporate Members with free access to those same educational programs. A discount code is needed when you register for a webinar, seminar, or workshop. If you need the discount code, please contact me or info@arias-us.org. We encourage you to take advantage of this great member benefit.

Finally, by the time you read this, I certainly hope that the integration between our association management system and the ARIAS website will be complete and Certified Arbitrators will be able to update their public-facing information once again on the ARIAS website Certified Professionals listing. We will continue to improve this integration and we will also start redeveloping the ARIAS website to provide more benefits and usability to members and the insurance/reinsurance community at large.

This issue of the Quarterly features three articles ranging from bad faith to comparative law. We start with another article by the prolific Robert M. Hall, of Hall Arbitrations, and a member of our Quarterly Editorial Board, responding to a recent article on whether follow-the-fortunes/follow-the-settlements should be implied. Titled, "Another View: Should Follow-the-Settlements/Fortunes Be Implied Into Reinsurance Contracts?" Bob explores how the courts have addressed this issue and adds his perspective as in-house counsel and an arbitrator.

We all know of the close relationship between insurance and reinsurance law in the United Kingdom and the United States. In "Intertwined Worlds of Insurance, Reinsurance, and the Law in the U.S. and U.K.," Michael Goldstein and Kristen Kish of Mound Cotton Wollan & Greengrass, provide us with a thoughtful analysis of the relationship and how those worlds are intermeshed with each other.

In June 2023, the Education Committee hosted a webinar on bad faith. Thankfully, the presenters turned the webinar into an article entitled "What's Going on With Bad Faith? The authors, James E. Fitzgerald, from Fitzgerald Legal Consult, P.C.; Erika M. Lopes-McLeman and Alfonse R. Muglia, from Dentons US LLP; and Jeffrey M. Rubin from Odyssey Re, take us through the latest bad faith developments and what they mean for insurers and reinsurers.

We hope you enjoy this issue of the Quarterly. We still need more of you to contribute to future issues. The deadlines and requirements are on the ARIAS website under Publications. We welcome committee reports, letters to the editor, original articles, and repurposed articles from ARIAS CLE programs just like the bad faith article or from company or firm publications. If you are on a panel at the Spring Conference, please turn your presentation into an article. Leverage your thought leadership and publish an article in the Quarterly. Your thought leadership is worthy of publication.

Larry P. Schiffer
Editor

Another View: Should Follow-the-Settlements/Fortunes Be Implied Into Reinsurance Contracts?

By: Robert M. Hall

I. Introduction

Environmental claims can involve multiple products, several locations, multiple years of exposure, and many more allegedly injured parties. The settlement of such claims and the allocation of costs can generate conflicts between primary insurers and their reinsurers. The doctrine of follow-the-settlements / fortunes is a tool to help resolve these conflicts.

While the terms "follow-the-settlements" and "follow-the-fortunes" are often used interchangeably today in judicial decisions, the terms have different historical meanings.[1] For present purposes, this article will use both terms used for these clauses unless the judicial decisions described below use one or the other term. A typical example of such a clause reads as follows: "All claims involving this reinsurance, when settled by [the cedent] shall be binding on the Reinsurer, which shall be bound to pay its proportion of such settlements."[2]

Follow-the-fortunes or follow-the-settlement clauses are often, but not always, used in reinsurance contracts. When omitted, this might be accidental, however, the author is aware that two of the largest domestic reinsurance companies[3] adopted a policy of purposefully omitting these clauses on the basis that they carry too much baggage.[4] The purpose of this article is to examine selected case law on whether the follow-the-settlements / fortunes doctrine should be implied into reinsurance contracts when the drafters omitted express language on point.

II. Purpose of the Follow-the-Settlements / Fortunes Doctrine

As one court noted, the purpose of the follow-the-settlements doctrine:

> [I]s to prevent the reinsurer from "second guessing" the settlement decisions of the ceding company. Absent such a rule, an insurance company would be obliged to litigate coverage disputes with its insured before paying any claims, lest it first settle and pay a claim only to risk losing the benefit of reinsurance coverage when the reinsurer raises in court the same policy defenses that the original insurer might have raised against its insured. This doctrine adjusts the incentives present in the reinsurance relationship in order to promote good faith settlements by the ceding company. . . . [T]he follow the settlements doctrine imposes upon the reinsurer a contractual obligation to indemnify the ceding company for payments it makes pursuant to a loss settlement under its own policy provided that such settlement is not fraudulent, collusive or otherwise made in bad faith, provided further that the settlement is not an *ex gratia* payment. . . . Consequently, subject to the requirements of good faith and a reasonable, businesslike investigation, the ceding company may bind the reinsurer to follow its settlements when it concedes that a particular claim falls within the scope of coverage provided by the ceding company's policy.[5]

> "...the purpose of the follow-the-settlements doctrine: [I]s to prevent the reinsurer from "second guessing" the settlement decisions of the ceding company."

III. Case Law Supporting Implying Follow-the-Settlements / Fortunes Clauses into Reinsurance Contracts

International Surplus Lines Inc. Co. v. Certain Underwriters, 868 F. Supp. 917 (S.D. Ohio 1994), involved a decision by a primary company to pay all Owens-Corning asbestosis losses on a one-occurrence basis. The reinsurance contract did not contain a follow-the-settlements/fortunes clause. The court rejected the reinsurers' arguments that the settlement was unreasonable. As to reinsurers' obligation to follow the fortunes of the cedent, the court stated:

> It is commonly understood that reinsurers must "follow the fortunes" of their insured. This fact may be formally expressed in an agreement of reinsurance. Even if it is not, the "Follow the Fortunes" doctrine [is] applied to all reinsurance contracts.[6]

In a very brief statement of support for its position, the *International* court cited *Mentor Ins. Co. v. Norges Brannkasse*, 996 F.2d 506 (2nd Cir. 1993), an article by Henry T. Kramer, former CEO of Swiss Re America[7] and a decision of a California federal district court, which was later reversed. It is not evident from the opinion that the court heard evidence of custom and practice with regard to follow-the-settlements.

Mentor involved in claims over the sinking of an oil rig. The cover note stated that the reinsurance coverage is "subject to all terms, clauses, conditions, and settlements as original but only to cover in respect of Total and/or Constructive and/or Arranged and/or Compromised Total Loss of Unit."[8] The special master below characterized this as a follow-the-fortunes clause and that follow-the-fortunes is a custom and practice for claims settled in good faith. The court, however, found the reinsurers liable for the cedent's claims based on the follow-the-fortunes clause in the relevant reinsurance contract.[9] So any discussion of implying it into the contract was *dicta*.

Another case that addressed the follow-the-settlements / fortunes issue in *dicta* was *American Employers' Insurance Co. v. Swiss Reinsurance America Corp.*, 275 F. Supp. 2d 29 (D. Mass. 2003). In footnote 32, the court adopted the position that follow-the-settlements is implied into reinsurance contracts. The court, however, found that the reinsurance certificate in question did not cover the cedent's claim.

Reliastar Life Insurance v. IOA Re, Inc., 303 F. 3d 874 (8th Cir. 2002), involved a retrocession of short-term health insurance under a contract that, apparently, did not include a follow-the-fortunes clause. The reinsurer sued the retrocessionaire for failure to pay claims and argued follow-the-fortunes. Initially, the court commented that the doctrine of follow-the-fortunes flowed from the doctrine of utmost good faith.[10] Next, the court ruled that the retrocessional contract did not incorporate language from the underlying contract that would contradict an obligation to follow the fortunes.[11] The court observed that experts on both sides agreed that follow-the-fortunes is a custom and practice of the reinsurance industry.[12] Given the lack of any anti-follow-the-fortunes language in the retrocessional contract, the court applied the doctrine to this dispute.[13]

Two out of three relevant facultative certificates contained a follow-the-settlements clause in *American Employers' Insurance Co. v. Swiss Reinsurance America, Corp.*, 275 F. Supp. 2d 29 (D. Mass. 2003). The underlying policy was for a three-year term and a dispute developed over the issue of whether the limit applied to each year (the cedent's position) or to the overall three-year term (the reinsurer's position). The court commented in *dicta*:

> Although not universally accepted, the favored view is that "follow the fortunes" and "follow the settlements" are an industry custom and apply even in the absence of express language to that effect. . . . This court adopts that view as well and uses the phrase "follow the fortunes" to refer to both the "follow the fortunes" and follow the settlements doctrines, as well as the use of language expressly within the reinsurance contract.[14]

However, the *American Employers'* court went on to find that the reinsurance certificate did not provide a limit per year and that "'Follow the fortunes' whether expressly in the contracts or not, does not alter this conclusion."[15] So the court's discussion of follow-the-fortunes was *dicta*.

"The *American Employers'* court went on to find that the reinsurance certificate did not provide a limit per year and that "'Follow the fortunes' whether expressly in the contracts or not, does not alter this conclusion."

A facultative certificate without a follow-the-settlements clause was involved in *Aetna Casualty & Surety Co. v. Home Insurance Co.*, 882 F. Supp. 1328 (S.D.N.Y. 1995). At issue was whether expenses were included within limits. The court heard expert testimony to the effect that follow-the-settlements is implied into reinsurance contracts but, apparently, no testimony to the contrary.[16] The court held for the cedent stating: "In view of the evidence, the court finds that it is customary within the reinsurance industry for reinsurers to follow the claim settlement decisions of the ceding company even in the absence of an explicit loss settlements clause."[17]

National Union Fire Insurance Co. v. American Re-Insurance Co., 351 F. Supp. 2d 201 (S.D.N.Y.), is a confusing decision involving the settlement of a pollution claim and a facultative certificate without a follow-the-fortunes clause but with a pollution exclusion broader than that in the underlying policy. The court referred to the certificate as a "reinsurance policy" and invoked the *contra preferendum* doctrine, used to protect insureds, for the benefit of a very large and sophisticated ceding insurer. The court commented that the reinsurer's pollution exclusion was too broad, and therefore ambiguous, therefore through follow-the-fortunes, the reinsurer's exclusion should be interpreted as identical to the exclusion in the underlying policy. The court went on to rule that the damages were not really the result of pollution, apparently making its comments on follow-the-fortunes *dicta*.

A retrocessional contract without a follow-the-settlements clause was at issue in Trenwick America Reinsurance Corp. v. IRC, Inc., 764 F. Supp. 2d 274 (D. Mass. 2011). The court found that the clause should be implied into the contract because experts for both the cedent and reinsurer agreed that follow-the-settlements "is a core tenant of the reinsurance business" and that "it obligates a reinsurer to indemnify the ceding company as long as the underlying insurance payments are made in good faith and within the terms and conditions of the reinsurance agreement."[18]

III. Case Law Declining to Imply Follow-the-Settlements / Fortunes Clauses into Reinsurance Contracts

National American Insurance Co. v. Certain Underwriters at Lloyd's, London, 93 F.3d 529 (9th Cir. 1996), involved claims under facultative certificates that did not contain follow-the-settlements clauses. The cedent offered expert testimony that such clauses were implied into reinsurance contracts by custom and practice and the underlying court ruled for the cedent on the basis that the expert testimony was uncontradicted. The Ninth Circuit found some contradictory evidence in the record and ordered a trial on the custom and practice issue:

> Based on an assertive amicus brief filed by the Reinsurance Association of America after our original opinions in this case, and our own review of the record and cases, we now find a factual question as to whether there existed within the facultative industry prior to the 1970's a custom or usage to "follow the settlements." Accordingly, a trial is necessary on this issue.[19]

Another facultative certificate without a follow-the-settlements / fortunes clause was at issue in *Village of Thompsonville v. Federal Insurance Co.*, 592 N.W.2d 760 (Ct. App. Mich. 1999). The court declined to follow *International Surplus Lines*, or to follow the *dicta* of several cases in which the contract contained follow-the-settlements clauses. The court found no Michigan authority for implying follow-the-settlements into the certificate and ruled accordingly.

An Ohio federal court again reviewed this issue in *North River Insurance Co. v. Employers Reinsurance Corp.*, 197 F. Supp. 2d 972 (S.D. Ohio 2002). The fact situation again involved a facultative certificate that did not contain a follow-the-settlements / fortunes clause. The court viewed the basis for the *International* court's ruling and subsequent case law. It found that one case supporting the earlier decision had been overturned, the language in another case was *dicta* and that the Henry Kramer article cited was equivocal on the specific issue at hand.[20] Unlike *Aetna Casualty & Surety*, there was expert testimony counter to the argument that follow-the-settlements is implied into all reinsurance contracts.[21] Accordingly, the court ruled for the reinsurer:

> Whether the "follow the fortunes" doctrine may be implied in a contract by reason of custom or policy will vary depending on which state's laws apply to the contract dispute. This strongly mitigates against a finding that the practice of implying a "follow the settlements" clause in every reinsurance contract is so widespread and accepted in the industry as to be beyond all factual and legal dispute. The above factors indicate that there is no sound basis for applying the "follow the settlements" doctrine in this case as a matter of law.[22]

Whether follow-the-settlements should be read into a facultative certificate as a matter of law was the issue in *American Insurance Co. v. American Re-Insurance Co.*, No. 05-01218, 2006 U.S. Dist. LEXIS 95801 (N.D. Cal., Nov. 27, 2006). After reviewing the above precedents, the court ruled for the reinsurer:

> The Court finds that the majority of the courts addressing this issue, and the better-reasoned opinions, have rejected the proposition that the "follow the settlements" or "follow the fortunes" doctrine may be implied into every reinsurance policy as a matter of law. In the absence of any authority from Pennsylvania on this issue, the Court will not impute the minority, less well-reasoned position to a Pennsylvania court. Accordingly, the Court . . . will . . . not read the "follow the settlements" or "follow the fortunes" doctrine into the reinsurance contract as a matter of law.[23]

Employers Reinsurance Corp. v. Laurer Indemnity Co., No. 8:03 cv 1650-T-17MSS, 2007 U.S. Dist. LEXIS 45670 (M.D. FL, Jun. 25, 2007), was a case in which the court interpreted a reinsurance contract without a follow-the-settlements / fortunes clause under Georgia law. The court found that the contract was not ambiguous under Georgia law and that extrinsic evidence on follow-the-settlements / fortunes was not admissible to vary the contract.

A series of facultative certificates that both parties agreed did not contain follow-the-settlements / fortunes clauses were at issue in *Utica Mutual Insurance Co. v Munich Reinsurance America Inc.*, Nos. 6:12-cv-00196 (BKS/ATB), 6:13-cv-00743 (BKS/ATB), 2018 U.S. Dist. LEXIS 107997 (N.D.N.Y., Jun. 27, 2018). The court declined to imply follow-the-settlements / fortunes into the certificates noting that "courts should be extremely reluctant to interpret an agreement as impliedly stating something which the parties have neglected to specifically include."[24]

> "The fact is that some reinsurers use follow-the-settlements / fortunes clauses in their contracts and some do not."

North River Insurance Co. v. Employers Reinsurance Corp., 197 F. Supp. 2d 972 (S.D. Ohio 2002), involved the settlement of asbestos-related claims under a facultative certificate that did not contain a follow-the-settlements / fortunes clause. Both sides requested partial summary judgment. After considering expert testimony and numerous treatises and articles, the court denied both motions finding that genuine issues of fact existed on the incorporation of a follow-the-settlements/fortunes clause.

Allocation of defense's costs in a settlement of asbestos-related claims under a facultative certificate was the issue in *Affiliated F.M. Insurance Co. v. Employers Reinsurance Corp.*, C.A. 02-419S (D. R.I. May 13, 2005). The certificate did not contain a follow-the-settlements clause. Observing that some reinsurance contacts contained those clauses and some did not, the court commented:

> It seems logical that if the "follow the settlements" doctrine was so widely accepted as an inherent part of every reinsurance contract that the doctrine may be read into every certificate as a matter of law, there would be no need to include such clauses in reinsurance contracts.[25]

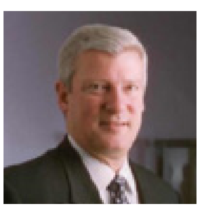
After expressing this view, the *Affiliated F. M.* court declined to imply a follow-the-settlements clause into the facultative certificate.

Public Risk Management of Florida v. Munich Reinsurance America, 38 F 4th 1298 (11th Cir. 2022), involved a dispute over whether the relevant wrongful acts occurred during the time a self-insurer was reinsured. The court found that the language of the reinsurance contract did not contain an express follow-the-fortunes clause and in fact, was contrary to that doctrine. The court held: "[T]his court will not infer application of the follow-the-fortunes doctrine in a reinsurance agreement where the agreement's plain and unambiguous language is inconsistent with the doctrine."[26]

IV. Discussion

The fact is that some reinsurers use follow-the-settlements / fortunes clauses in their contracts and some do not. This is evident not only from the author's personal experience but also from the numerous cases cited above involving reinsurance contracts without those clauses. Indeed, the issue of implying clauses into reinsurance contracts would not arise if they were in universal use. At least one of the reasons that reinsurers decline to use these clauses is the baggage they can bring into coverage rulings.[27]

A minority of judicial decisions support implying follow-the-settlements / fortunes into reinsurance contracts and most of this support is in dicta. A majority of judicial decisions, which are holdings, do not support implying these clauses into reinsurance contracts based on a reluctance to imply terms into contracts between sophisticated parties, especially when the custom and practice are in controversy.



Bob Hall is an attorney, a former law firm partner, and a former insurance and reinsurance executive and acts as an arbitrator of insurance and reinsurance disputes and as an expert witness. He is a veteran of over 200 arbitration panels and is certified as an arbitrator and umpire by ARIAS·U.S. The views expressed in this article are those of the author and do not reflect the views of his clients. Copyright by the author 2023. Hall has authored more than 100 articles and they may be viewed at his website: robertmhall.com. He can be reached at bob@robertmhalladr.com.

ENDNOTES

1 Historically, "follow the fortunes" is an underwriting doctrine whereas "follow the settlements" is a claims doctrine. Robert M. Hall, *How Follow the Fortunes Differs from Follow the Settlements*, ARIAS·US Quarterly Q4 2022.

2 *American Employers' Ins. Co. v. Swiss Reinsurance America*, 275 F. Supp. 2d 29 at 33 (D. Mass. 2003).

3 American Re-Insurance Company (now part of the Munich Re Group) and Employers Reinsurance Company, (now part of the Swiss Re Group). I was Senior Vice President and General Counsel of American Re and the Contract Department reported to me. I later acted as an expert witness for Employers Re and learned their policy from their fact witnesses.

4 Examples of the baggage are extreme allocation decisions such as *North River Ins. Co. v. Ace American Reinsurance Co.*, 361 F.3d 134 (2nd Cir. 2004), and *Travelers Casualty & Surety v. Gerling Global Reinsurance Corp.*, 419 F.3d 181 (2nd Cir. 2005), in which the courts acknowledged that bad faith on the part of the cedent was an exception to follow-the-settlements / fortunes but denied the reinsurer the discovery necessary to show bad faith.

5 *Aetna Cas. & Surety Co. v. Home Ins. Co.*, 882 F. Supp. 1328 at 1346 – 7 (S.D.N.Y. 1995).

6 5 868 F. Supp. 917 at 920.

7 Henry T. Kramer, *The Nature of Reinsurance*, published in Reinsurance, The College of Reinsurance, May 1984 edition at 11 – 12 (hereinafter "Kramer"). Mr. Kramer's comments are a good deal more equivocal that the court's citation suggests:

> It is the traditional and normal position of the parties to a reinsurance that . . . a reinsurer shall also and in any case "follow the fortunes" of the insured as if the reinsurer were a party to the original insurance. This seems to speak for itself but in practical usage problems can arise. . . .
>
> It is clear that this understanding (which may or may not be expressed in an agreement of reinsurance but nevertheless exists for all) does not supersede stated limitations and exclusions in a reinsurance agreement. Neither is it a means by which the reinsurer be taken right outside the contract of reinsurance on a matter about which the contract is silent or allegedly ambiguous. . . .
>
> Perhaps no feature of the reinsurance relationship is more subject to ingenuous exaggeration than the duty to follow the fortunes . . . .

8 996 F.2d 506 at 508.

9 *Id.* at 516 – 7.

10 303 F. 3d 874 at 878.

11 *Id.* at 880.

12 *Id.* at 881.

13 *Id.*

14 275 F. Supp. 29 at n. 32.

15 *Id.* at 39.

16 882 F.3d at 1348 – 50.

17 *Id.* at 1350.

18 764 F. Supp. 2d 274 at 297.

19 93 F.3d at 537.

20 On the latter point, *see* fn 7, *supra*.

21 197 F. Supp. at 984 – 6.

22 *Id.* at 946.

23 2006 U.S. Dist. LEXIS * 15 – 6.

24 2018 U.S. Dist. LEXIS 107997 *70.

25 *Slip op.* at 21.

26 38 F. 4th 1298 at 1301.

27 *See* fn. 4, supra.

Intertwined Worlds of Insurance, Reinsurance, and the Law in the U.S. and U.K.

By: Michael H. Goldstein, Esq. and Kristen Kish, Esq.

In late May 2023, the Second Circuit Court of Appeals issued a detailed and complex decision that demonstrates in an unusually lucid fashion that the interconnected worlds of U.S. and U.K. insurance and reinsurance law — despite being populated by a people "divided by a common language" and separated by the proverbial "pond" — remain forever conjoined. *The Insurance Company of the State of Pennsylvania v. Equitas Insurance, Ltd.*, No. 20-3559 (2d Cir., May 23, 2023).

The interconnected U.S. and U.K. insurance/reinsurance industries are governed by two independent legal systems, yet manage to co-exist in remarkable harmony, aided by able and diligent lawyers and jurists. This decision, in the authors' view, also shows, yet again, that U.S. courts are more than capable of understanding, analyzing, and adjudicating complex insurance coverage issues and reinsurance disputes involving both U.S. and U.K. law.

Given the ubiquitous nature of arbitration clauses in reinsurance contracts (especially treaties), this type of public, reasoned, and articulate decision stands out as a significant benefit to both the U.S. and U.K. insurance and reinsurance business communities. Even were an arbitration panel qualified and able to render such a complex and multi-layered case law-driven award/decision, it would almost surely remain confidential and thus be of no value to anyone beyond the parties to the dispute. Moreover, there are many federal court judges (and even some state court judges) familiar with and experienced in adjudicating complex insurance and reinsurance disputes. And, as discussed over many years at industry conferences, many of those judges have been tutored by reinsurance practitioners (including expert witnesses) and attorneys in some very high-stakes litigations, i.e., the very same professionals who populate the reinsurance arbitration community. Thus, much of the body of U.S. reinsurance case law developed over the last thirty-five years, as observed up close by these authors, has been derived from the joint efforts of astute counsel, their knowledgeable clients, expert witnesses, and able judges. It is clear that litigation remains an integral component of the insurance/reinsurance dispute resolution universe, rather than an alien process outside the industry it serves and continues to be an important complement to the arbitration process.

> “It is clear that litigation remains an integral component of the insurance/reinsurance dispute resolution universe, rather than an alien process outside the industry it serves and continues to be an important complement to the arbitration process.”

The Underlying Dispute

The dispute in *Equitas* arose out of ICSOP’s umbrella liability coverage of Dole Foods from 1968-71. In 2009, homeowners in Carson, California sued Dole for groundwater contamination and pollution of their soil. Dole and ICSOP settled the claims and allocated $20 million of their settlement to the ICSOP-Dole policy even though the alleged property damage continued long after the policy period. The insured and insurer/cedent applied the “all sums rule” in allocating the settlements. Under California law, the “all sums rule” “treats any insurer whose policy was in effect during any portion of the time during which the continuing harm occurred as jointly and severally liable (up to applicable policy limits) for all property damages or personal injuries caused by a pollutant.” *The Ins. Co. of the State of Pennsylvania v. Equitas Ins., Ltd.*, No. 20-3559, at p. 3 (2d Cir., May 23, 2023).

Based on that allocation, ICSOP then billed its reinsurer, Equitas (successor to Lloyd’s syndicates), under a facultative reinsurance policy provided via Lloyd’s policy form J1 (the “Policy”). Lloyd’s policy form J1 is extremely brief and rather vague, at least compared to U.S. facultative certificates and London reinsurance slip policies of more recent vintage. The face sheet of the Policy bears the Lloyd’s seal with the assertion that the form is “approved by Lloyd's Underwriters Fire and Non-Marine Association” and bears the legend at the bottom “Form J1(6.8.59)”. The Policy provides on its face sheet that, “[i]n the event of any occurrence likely to result in a claim under this Policy, immediate notice should be given to: [Underwriters]." This language is the entire notice of loss provision. The only other relevant term in the Policy is what most would consider a very brief, short form "follow the settlements" clause, oddly not cited by the court until almost the very end of the lengthy decision:

> Now We the Underwriters hereby agree to reinsure against loss to the extent and in the manner hereinafter provided:
>
> > [Coverage] is "as Original" and will provide the "same gross rate, terms and conditions and to follow the settlements of the Company ….

Equitas denied the claim on the grounds that, under English law, the "all sums rule" does not apply and, further, that the six-year delay in notice of the claim barred recovery under the Policy. ICSOP disagreed on the grounds that English law would interpret the Policy as "back to back" with the reinsured policy, recognize the "all sums rule," deem the notice of loss to be timely, and hold that, absent timely notice of loss being a condition precedent to coverage under the Policy, extreme prejudice must be shown to avoid reinsurance coverage, something Equitas could not demonstrate.

The district court rejected Equitas's defenses and granted summary judgment to ICSOP. On appeal, the Second Circuit conducted its review de novo and affirmed the district court decision in a detailed and exhaustive decision that combines an analysis of the "all sums rule" under California law, with an analysis of English insurance coverage law including the "all sums rule," and an analysis of basic English reinsurance law.

The Appellate Ruling

The court first addressed U.S. tort and insurance law. After a survey of the development of mass-tort law and the related insurance coverage issues that have arisen in the U.S., the court concluded that a significant number of courts have adopted the "all sums rule," including Hawaii and California, and that the ICSOP policy was governed by Hawaii law. The court also explained that, while many courts have adopted a *pro rata* rule, many have not adopted either rule. As a court sitting in alienage jurisdiction (i.e., jurisdiction of federal courts over U.S. citizens and citizens of foreign states under 28 U.S.C. Sec. 1332), it then set out to determine how an English court would rule "in the context of reinsurance law." In doing so, the court engaged in an analysis of how English courts have approached these thorny insurance coverage issues in the context of mass-tort liability.

The court engaged in a survey of English tort law involving long-term exposure to toxic substances, such as asbestos. The court cited *Fairchild v. Glen Haven Funeral Services Ltd.*, [2003] 1 AC 32 (HL) ¶¶ 3-5 (Lord Bingham), *Barker v. Cory's UK Ltd, Barker v. Corus UK Ltd.*, [2006] 2 AC 572 (HL), and the U.K. Compensation Act 2006 c. 29 § 3 ("Compensation Act"), which reversed part of *Barker* – a case that itself had rejected a rule that apportioned tort liability among several employers on a joint and several basis. Although the Compensation Act applies only to mesothelioma, the Act set the stage for the adoption of the "all sums rule" by the U.K. courts, at least for certain types of mass torts:

> [W]hen a victim contracts mesothelioma each person who has, in breach of duty, been responsible for exposing the victim to a significant quantity of asbestos dust and thus creating a material increase in risk of the victim contracting the disease will be held to be jointly and severally liable in respect of the disease.

Following the enactment of the Compensation Act of 2006, the U.K. Supreme Court held in a subsequent case, *Trigger (Durham V. BAI (Run off) Ltd.*, [2012] UKSC 14 ¶ 78, that insurers providing coverage to employers who are liable under the Act are likewise liable under their policies for such claims against their insureds. And, in *Trigger*, the U.K. Supreme Court held that "where two contracts are linked—as in the reinsurance contract—'the law will try to read them consistently with each other.'" Then, in *Zurich Ins. PLC Branch v. International Energy Group Ltd.*, [2015] UKSC 33 ¶¶ 45-51, 54, 94-97, the U.K. Supreme Court held that insurers are jointly and severally liable on an "all sums" basis for their insured's liability when the insured is liable under the Compensation Act. The Court there held that, "once one accepts that causation equates with exposure, in tort and tort liability insurance law . . . there is no going back on this conclusion simply because there was exposure by the insured of the victim both within and outside the relevant insurance [coverage] period," despite the fundamental importance under English law of the insurance policy period as *Wasa International Insurance Co, v. Lexington Insurance Co.*, [2010] 1 AC 180 (HL) ¶ 32, had made clear. The U.K. Supreme

Court therefore held that the primary question concerned "the duty that the insurer owes to the insured - not the relative position between two insurers" and, thus, "there is . . . nothing illogical about a conclusion that each of successive insurers is potentially liable in full, with rights of contribution inter se." But the court noted, of course, that the Compensation Act did not apply in *Equitas* and, moreover, that the term or policy period of a policy is afforded fundamental respect and importance in English law.

The Second Circuit then turned to the matter at hand between the plaintiff-cedent and its reinsurer, and whether the U.K. Supreme Court would interpret the reinsurance contract as entitling ICSOP to recover from its reinsurer, even though, under English law, the "all sums" principle would not govern ICSOP's liability under its policy. The critical issue was, however, whether under U.K. law, Equitas would be liable under the Policy for the payments ICSOP made to its insured. Citing *Wasa*, the court stated that, under English law, facultative reinsurance is normally "back to back" with the reinsured insurance policy so that where the insurer is liable, the reinsurer pays its agreed proportion of the risk, and went so far as to call it a "strong presumption" in favor of coverage. Most critically, that presumption would follow even if the insured's losses were payable in a foreign jurisdiction where the law varies from English law.

The court noted that in *Wasa*, a case upon which Equitas relied, the original policy did not contain a choice of law clause and, therefore, it was not predictable at the time of issuance of the reinsurance contract that Pennsylvania law would govern its interpretation. But the ICSOP-Dole policy contained a Hawaii choice-of-law clause and, generally speaking, Hawaii law generally follows California law, including the "all sums rule" applied to multiple years of coverage for continuous and indivisible injuries. The absence of a choice of law clause in *Wasa* was critical and distinguished it from *Equitas* where there was, indeed, a choice of law clause in the reinsured policy.

> "The court further pointed out that, under English law, reinsurers must accept the risk of a change in law after formation of the contract..."

The court further pointed out that, under English law, reinsurers must accept the risk of a change in law after formation of the contract, i.e., the development of the "all sums" principle that did not exist when the subject reinsurance contract was formed decades earlier: "[t]hus when parties fail to define in their insurance agreements a term such as 'all sums' . . . they adopt the meaning a common law court will ascribe to it, and thereby bear the rewards and risks of the common law's dynamic nature." *Equitas*, No. 20-3559 at p. 41. The court referred again to *Trigger* and *Zurich*, where the U.K. Supreme Court ruled as it did despite the relevant policies being issued prior to the relevant legal developments that formed the basis of those Courts' decisions. The court concluded that the U.K. Supreme Court would, in this instance, not rule contrary to how it had ruled in the past, mainly because the Policy expressly warranted coverage as "Original." The court stated:

> Equitas therefore cannot confine its current obligations to what those obligations would have been had the dispute arisen fifty years ago . . . This case unquestionably presents an issue that was left open in *Wasa*, and has not since been resolved by the [UK] Supreme Court. We thus cannot be certain that our prediction as to how that Court would resolve this case [in the UK] is correct. But it remains our [duty] to make our best considered judgement of how [the UK] court would decide the issue . . . and for the reasons set forth above, we conclude

that under English law the back-to-back presumption [applied to facultative reinsurance] is strong, and we do not believe that the [UK] Supreme Court would condition that presumption on the importance of a policy term or the predictability of how a foreign court might later interpret that term. Accordingly, the back-to-back presumption [in construing a reinsurer's obligations] applies to the reinsurance policy, thus rendering the parties' obligations co-extensive.

Equitas, No. 20-3559 at pp. 41-42.

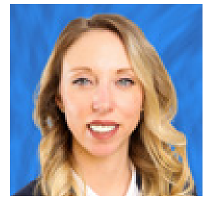
Late Notice Defense

The court easily disposed of the reinsurers' late notice defense because, under English law, unless prompt notice of loss is a condition precedent to coverage, extreme prejudice must be shown by the reinsurer. The court concluded that the reinsurers could not demonstrate "extreme prejudice" and that there was, therefore, "no reason to go where no English court has gone." *Id.* at p. 45.

Conclusion

The *Equitas* decision, while perhaps not entirely unprecedented, is nevertheless remarkable in vividly illustrating the interconnected legal and insurance/reinsurance arenas in the U.S. and the U.K. While the two legal systems have many differences, those systems and the inter-connected worlds of U.S. and U.K. insurance and reinsurance, remain closely bound and intertwined. And, despite the continued prevalence of arbitration in the reinsurance industry, this thorough and painstaking decision demonstrates the continued vitality and importance of litigation with its published reasoned and often valuable decisions.

Michael H. Goldstein, Esq. has been practicing law since 1980 in the insurance space and in reinsurance since 1985 at Mound Cotton where he worked closely with the late Gene Wollan in multiple arbitration hearings to award (and one very significant federal court trial and appeal); and then for over 20 years collaborated with Larry Greengrass as co-first chair at many hearings. Goldstein has been first chair/co-first chair in over 50 arbitration hearings to award and has argued multiple appeals in the federal circuit courts of appeal. Goldstein has represented both cedants and reinsurers and has made law in many landmark decisions in the federal and state appellate courts. Goldstein also has handled complex reinsurance disputes involving all lines of business and types of claims. In addition, Goldstein has authored multiple articles in insurance and reinsurance journals and has lectured on many insurance and reinsurance topics over the last 25 years.



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What's Going on With Bad Faith?

By: James E. Fitzgerald, Erika M. Lopes-McLeman, Alfonse R. Muglia, Jeffrey M. Rubin

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Introduction

The authors of this article came together last summer for an ARIAS webinar to discuss the current state and development of insurance bad faith litigation around the country. That discussion focused on how courts in recent years have continued to apply common law and statutory bad faith principles to the various specific circumstances that can arise during the claims handling process. How insurers and policyholders deal with each other continues to evolve as the world tackles issues raised by the COVID-19 pandemic, increased catastrophic exposures from storms and wildfires, and legislative developments in states like California and Florida. Overlaying these topics are the advancement and implementation of artificial intelligence technologies and their overall impact on the insurance/reinsurance industry, which are widely reported in other sources, including a December 2023 ARIAS webinar. Time will tell how these developments impact bad faith jurisprudence.

This article is in no way intended as a full treatise on bad faith law. Rather, it will address some current issues and future trends in bad faith law that impact direct insurers and reinsurers.

Bad Faith – How Does It Arise?

A contract of insurance typically requires that, in the event of a covered loss, the insurer pays the policy benefits when due. In every insurance contract there is an implied covenant of good faith and fair dealing – a breach of which is known as "bad faith." It is something beyond a breach of specific contractual duties or mistaken judgment. While a failure to pay policy benefits when due may be a breach of contract, it may also be a tort if that failure is unreasonable or without proper cause. In that case, whether an insurer will be liable for common law and/or statutory bad faith in tort depends on which state's law applies.

In many states, but not all, a claim for bad faith can only be sustained if there has been a breach of the insurance contract. In some states, even if there is no coverage, and therefore no breach of contract, an insurer may still be liable for bad faith if it has breached the covenant of good faith and fair dealing and/or violated a bad faith statute (e.g., unfair claims settlement practices).

Bad faith cases can arise in claims dealing with first-party and third-party property coverage, life, health, disability, professional liability, and innumerable other types of claims arising out of personal and commercial lines of insurance. However, generally, a party to a direct insurance claim cannot sustain a bad faith claim against a reinsurer of the cedent's policy covering that party because there is no privity of contract between the direct insured and the reinsurer. Nevertheless, the law of insurance bad faith impacts reinsurers in several ways, which this article will explore.

> "...the law of insurance bad faith impacts reinsurers in several ways..."

Recent Developments in First-Party Insurance Claims

1. "Genuine Dispute" Defense to Bad Faith.

One of the principal defenses used by insurers to defeat a bad faith claim is the "genuine dispute" doctrine. As a matter of law, if an insurer delays or denies the payment of policy benefits "due to the existence of a genuine dispute with its insured as to the existence of coverage liability or the amount of the insured's coverage claim," the insurer is not liable for bad faith even though it might be liable for breach of contract. *Fed. Ins. Co. v. Tungsten Heavy Powder & Parts, Inc.*, 654 F. Supp. 3d. 1086, 1109 (S.D. Cal. 2023) (citations omitted). Put differently, the insurer's denial or delay in paying policy benefits must have been unreasonable or without proper cause to qualify as bad faith conduct.

This principle was recently confirmed in *Lemon v. State Farm Fire & Casualty Co.*, No. 3:20-cv-3018, 2022 WL 2317444 (N.D. Iowa 2022), a first-party property case arising out of a residential house fire. State Farm investigated the fire and, after retaining an expert in fire analysis, concluded that the circumstances of the fire pointed to arson and denied the claim. The insureds sued for breach of contract, bad faith, and punitive damages. The court granted State Farm partial summary judgment on the claim for bad faith and punitive damages finding that the insureds' claim was "fairly debatable" because reasonable minds could differ on the coverage-determining facts or law (*i.e.*, a reasonable basis existed for denial of policy benefits as a matter of fact or law). Further, the court noted that a defendant can defeat a bad faith claim by showing at least one, but not necessarily all, of its bases for denying coverage was reasonable. This is the heart of the genuine dispute doctrine. *See also, Mosley v. Pac. Spec. Ins. Co.* (2020) 49 Cal. App. 5th 417, 435-436; *501 East 51st Street, Long Beach-10 LLC v. Kookmin Best Ins. Co*. (2020) 47 Cal. App. 5th 924; *Feldman v. Allstate Ins. Co.*, 322 F.3d 660 (9th Cir. 2003).

2. Delay in Payment of Undisputed Repair Costs

In *Charter Properties v. Rockford Mutual Ins. Co.*, 119 N.E.3d 15 (Ill. Ct. App. 2018), the insurer was found liable for unreasonable and vexatious delay in settling the insured's first-party property claim following a building collapse. First, the jury found that the insurer paid portions of the claim as it progressed but failed to pay all undisputed amounts within a reasonable time. Second, the insured's claims for bad faith under Illinois' bad faith statute then proceeded to a bench trial in which the judge found that the insurer's overall handling of the claim was unreasonable and vexatious. For example, when the insured submitted its statement of proof of loss, the insurer held it in abeyance pending completion of its inspection, then rejected it as premature because the rebuild was not complete. Less than a month later, the defendant pulled the adjuster off the project without completing a final estimate of loss. Thus, the court awarded the insured other costs, including attorney fees and costs.

3. Company Procedures Violative of Consumer Protection Laws.

Policyholders often invoke bad faith statutes to challenge insurers' claims adjustment policies. An ongoing closely watched set of cases involves plaintiffs' claims on behalf of a purported class that an insurer's adjustment policy for determining a vehicle's total loss valuation that applies a "typical negotiation" adjustment to the valuation report it obtained from Audatex violates consumer protection laws. *See, e.g., Williams v. State Farm Mut. Ins. Co.*, No. 22-cv-1422 (N.D. Ill.). These cases remain in their early stages but represent how insurance company claims handling policies – separate from the day-by-day claim handling – can have bad faith implications.

"Policyholders often invoke bad faith statutes to challenge insurers' claims adjustment policies."

Recent Developments in Third-Party Bad Faith Claims

1. Failure to Settle Within Policy Limits.

In many jurisdictions, the insured in a bad faith refusal to settle case must first show that the settlement demand was reasonable and within the policy limits. Some insureds have argued that, once that fact is established and then there is an excess judgment, the insurer is strictly liable in bad faith for the full amount of the judgment, even if it exceeds the policy limits. That "strict liability" standard was recently rejected in *Pinto v. Farmers Insurance Exchange* 61 Cal. App. 5th 676 (2021). The California Court of Appeal held that the special verdict was facially insufficient to support a bad faith judgment because it included ***no finding that the insurer acted unreasonably*** in failing to accept the settlement offer. The court noted that the special verdict form did not ask the jury to determine whether the insurer acted unreasonably, and that because that inquiry was a critical element needed for a bad faith finding the verdict was at odds with the whole concept of determining bad faith. In other words, "[a]n insurer's good or bad faith must be evaluated in light of the totality of the circumstances surrounding its actions." *Hedayati v. Interinsurance Exch. of the Auto. Club*, 67 Cal. App. 5th 833, 843 (2021) (citation omitted).

2. Time Limited Demands/Responses.

Time limited demands have become the subject of statutory enactment in several states (e.g., Georgia and Missouri) to provide some clarity to an insurer's response to settlement demands within policy limits. California has responded to this issue with enactment of California *Code of Civil Procedure* Section 999, et seq., which went into effect on January 1, 2023. It provides time limits for an insurer to respond to pre-litigation settlement demands for certain liability claims (e.g., homeowner and auto claims, but not errors and omissions claims). The statute requires that the settlement demand be written, be specific and within policy limits, offer a full release, be made prior to the filing of a complaint or demand for arbitration, and allow acceptance within not fewer than 30 days from the demand being made.

3. Consent Agreements.

Courts continue to wrestle with situations where claimants and policyholders reach a consent agreement or consent judgment, without the insurer's involvement, and then look to the insurer to pay the stipulated judgment amount. A court's finding that the agreement was (1) fraudulent, collusive, or in bad faith, or (2) unreasonable will generally result in the court holding it is ***not*** enforceable against the insurer. *See Phila. Indem. Ins. Co. v. Bogel*, 269 A.3d 992, 996 (Del. Super. Ct. 2021). In *Abbey/Land, LLC v. Glacier Construction Partners, LLC*, 433 P.3d 1230 (Mont. 2019), the Montana Supreme Court affirmed that a general contractor's confessed judgment was unreasonable and the product of collusion under the facts of that case. After the threshold question of whether the consent judgment is enforceable, the court must determine whether that consent judgment in excess of policy limits constitutes an excess judgment for which the insurer is fully liable. *See McNamara v. Govt. Emp. Ins. Co.*, 30 F.4th 1055 (11th Cir. 2022) (holding under Florida law that plaintiffs could prove causation in bad faith case with excess consent judgments).

Impact of Bad Faith Developments on Reinsurance

Reinsurers are not generally subject to third-party bad faith claims because no privity of contract exists between reinsurers and the insured and therefore no duty is owed from a reinsurer to the insured. The duty of utmost good faith is owed by the reinsured to the reinsurer – not the insured. However, reinsurers may contractually agree to indemnify reinsureds for their exposure to Extra Contractual Obligations ("ECO") and Excess of Policy Limits ("XPL"). Reinsurance contracts may also include the "Right to Associate" which, if exercised, would permit the reinsurer to become more involved in the handling of a particular claim made by the insured or a third party.

> "A reinsured owes a duty of utmost good faith to its reinsurer."

1. Privity of Contract

Contracts of reinsurance are between the reinsurer and the insurer/reinsured. The insured is in privity of contract with the insurer, but not with the reinsurer. *See Ascherman v. Gen Re. Corp.*, 183 Cal. App. 3d 307, 312 (1986). In the absence of other specific provisions, the reinsurer has no obligation to the original insured and, conversely, the insured has no right of action against the reinsurer. *Id.*

2. Duty of Utmost Good Faith

A reinsured owes a duty of utmost good faith to its reinsurer. *Munich Reinsurance Am., Inc. v. Am. Nat'l Ins. Co.*, 601 Fed. Appx. 122 (3d Cir. 2015). A breach of the duty of utmost good faith justifies rescinding the reinsurance contract. *Id.* The duty of utmost good faith requires the reinsured to disclose to the reinsurer all facts that materially affect the risk. *Christiania Gen. Ins. Corp. v. Great Am. Ins. Co.*, 979 F.2d 268, 278 (2d Cir. 1992). Rescission may be warranted where the reinsured breaches the duty of utmost good faith. For example, where the description of items covered under the original policy provided by the reinsured to the reinsurer was so imprecise that the reinsurer was not adequately apprised of the risk, rescission may be warranted. *Id.*

3. Contract Wording

Reinsurers may contractually agree to indemnify reinsureds for ECO and XPL liability. In pro rata reinsurance agreements, ECO and XPL may be included within the definition of Ultimate Net Loss. In Excess of Loss reinsurance agreements, the reinsurer may agree to provide a percentage of an additional limit for ECO and EPL.

An example of reinsurance contract wording defining ECO and EPL follows:

> "“Extra Contractual Obligations” and “Excess of Policy Limits” shall mean the following:
>
> 1. “Extra Contractual Obligations” as used in this Contract will mean those liabilities not covered under any Policy reinsured hereunder, which arise from the handling of any claim on business covered hereunder; such liabilities arising because of, but not limited to, the following: failure to settle within the Policy limit, or by reason of alleged or actual negligence, fraud, or bad faith in rejecting an offer of settlement, in the preparation of the defense, in the trial of any action against

the insured or reinsured, or in the preparation or prosecution of an appeal consequent upon such action."

2. "Excess of Policy Limits" as used in this Contract will mean damages payable in excess of the original Policy limit as a result of the Reinsured's handling of any claim on business covered hereunder, such liabilities arising because of, but not limited to, the following: failure to settle within the Policy limit, by reason of alleged or actual negligence, fraud, or bad faith in rejecting an offer of settlement, in the preparation of the defense, in the trial of any action against the insured or reinsured, or in the preparation or prosecution of an appeal consequent upon such action. Excess of Policy Limits is any amount for which the Reinsured would have been contractually liable to pay had it not been for the limits of the reinsured Policy."

4. Reinsurer's Right to Associate

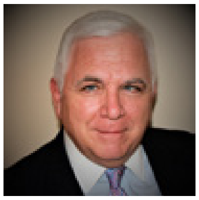
Reinsurance agreements may include a "Right to Associate," which grants the reinsurer the option of "associating" with the reinsured in the handling of a third-party claim against the insured. A "Right to Associate" clause would typically be found under the "Loss Settlements and Loss Adjustment Expenses Article." An example of "Right to Associate" wording that may be included in a reinsurance agreement follows:

> "When requested by the REINSURER, the COMPANY shall permit the REINSURER, at the expense of the REINSURER, to be associated with the COMPANY in the defense or control of any claim, loss, or legal proceeding which involves or is likely to involve the REINSURER."

Involvement by reinsurers in the handling of claims brought against their reinsureds can lead to attempts by insureds to proceed directly against the reinsurer. Two courts have considered novel theories presented by insureds attempting to proceed directly against reinsurers. In *Reid v. Ruffin*, 469 A.2d 1030 (Pa. 1983), the court rejected the theory that there was a third-party beneficiary contract between the insured and the reinsurer and found the reinsurance agreement did not create an agency relationship. The reinsurer was held not liable for a judgment in excess of policy limits where it did not have the right to control the settlement, nor did it participate in the same. *Id.* In *Peerless Insurance Co. v. Inland Mutual Insurance Co.*, 251 F.2d 696 (4th Cir. 1958), the court held that a reinsurer that was kept apprised of, and consulted with respect to, developments regarding a claim, but which did not exercise the right to associate or to consent, was in a "joint enterprise" with the insurer and responsible for its proportionate share of an excess verdict.

Other courts have addressed cases in which insureds proceeded directly against reinsurers, in the context of adjudicating preliminary issues. In *Midtown Hotel Group LLC v. Selective Insurance Co.*, No. CV-22-01395-PHX-JAT, 2022 WL 17811683 (D. Az. Dec. 19, 2022), the court permitted a policyholder to file an amended complaint against a reinsurer alleging breach of contract as a third-party beneficiary, bad faith, and aiding and abetting.[1] The amended complaint also alleged that the reinsurer acknowledged coverage of the claim, appointed an employee to be the primary point of contact regarding the claim, and noted the reinsurer controlled decisions regarding payment and settlement of the claim. *Id.* In *Travelers Indemnity Co. v. Alto ISD*, No. 12-21-00143-CV, 2022 WL 1668859 (Ct. App. Tx., 12th Dist. May 25, 2022), the court affirmed the denial of a motion to compel arbitration brought by a reinsurer who had been sued by independent school districts in Texas that had purchased first party property insurance coverage from the Texas Rural Education Association Risk Management Cooperative ("TREA"), which was reinsured by Travelers. *Id.; see also Travelers Indem. Co. v. Alto Indep. Sch. Dist.*, No. 3:21-CV-909, 2022 WL 2981594 (D. Conn. July 28, 2022); *aff'd Travelers Indem. Co. v. Grapeland Indep. Sch. Dist.*, No. 22-1760-cv, 2023 WL 8539912 (2d Cir. 2023) (holding that Travelers failed to establish it was entitled to application of the direct benefits estoppel theory on the merits).

The school districts alleged violations by Travelers of the Texas Insurance Code, fraud, conspiracy to commit fraud, violations of the Texas Deceptive Trade Practices Act, misrepresentation, and negligence for failing to provide full compensation for claims as a result of purported storm damage to their properties. *Id.*



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Fitzgerald began his career practicing in New York at the national insurance firm Mendes Mount, where his practice focused on lawyer's professional liability, directors and officers, and reinsurance matters. In the mid-1980s, Fitzgerald moved to Los Angeles where he began practicing general business litigation with an emphasis on complex insurance/reinsurance cases representing insurers, and, on occasion, insureds. Fitzgerald has practiced at a number of large national/international firms since moving to Los Angeles – most recently Stroock Stroock Lavan, Akin Gump Strauss Hauer Feld, and Drinker Biddle Reath (now Faegre Drinker).

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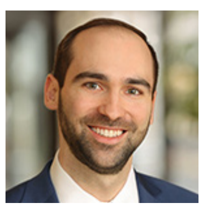

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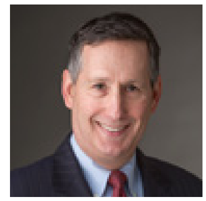


Jeffrey M. Rubin has more than 40 years of experience in the insurance and reinsurance industry as Senior Officer and General Counsel of reinsurance and insurance companies and as Outside Counsel representing reinsurance and insurance companies. Chief claims officer responsible for oversight of all claims within the group for global reinsurer, including insurance subsidiary, for eighteen years. General Counsel, Director of Litigation, and Reinsurance Specialist for property and casualty insurance companies for six years. Partner in Chicago law firm handling reinsurance litigation and insurance coverage litigation for thirteen years. Has overseen numerous reinsurance arbitrations and disputes in the United States and England. Has served as outside counsel, party-appointed arbitrator, and umpire in several arbitration proceedings to final decision before the National Futures Association and in private arbitration proceedings.

Endnotes

1 The district court did note that the relationship between the parties was unclear due to the secrecy of the reinsurance agreement. *Id.*

Claim Against Insurers for Breach of Premium Financing Contract Dismissed

The Complaint alleged that three men (the "Principals") ran a fraudulent scheme to misappropriate over $21 million in premium finance loans issued by Ameris Bank. Premium finance companies offer policyholders "a means to buy insurance and pay for it in manageable periodic payments plus a finance charge[.]" *See Sheeran v. Sitren*, 168 N.J. Super. 402, 410 (Law. Div. 1979).

The Principals carried out the scheme using four of their affiliated insurance agencies—ABC Inc., Brandywine, Trigen, and NSU ("the Principals' Agents"). The Principals' Agents submitted premium finance applications to Ameris Bank on behalf of purported policyholders (the "Borrowers") of certain insurance companies, including Clear Blue Insurance Company and Beazley Insurance Company ("Insurers"). Unaware of the fabricated insurance policies included with the applications, Ameris Bank approved the applications and entered into premium finance contracts with the Principals' Agents and Borrowers. The Principals allegedly took the loan proceeds and, together with the Borrowers, used them for their own illegal purposes.

Plaintiff asserted that the Principals' Agents were independent insurance agents for the Insurers and had "apparent and implied authority to write policies of insurance for the Insurers." Plaintiff also asserted that, upon issuing the premium finance loans, Ameris Bank sent notices to the Insurers but received no response from them. Primarily based on these allegations, Plaintiff brought two counts against the Insurers: (1) breach of the premium finance contracts; and (2) aiding and abetting the Principals' violations of New Jersey Racketeer Influenced and Corrupt Organization Act ("NJRICO") and conversion. The Insurers moved to dismiss both counts.

On December 15, 2022, the New Jersey Superior Court dismissed with prejudice Plaintiff's breach of contract claim against the Insurers. The Court held that the Insurers were not parties to the premium finance contracts. The Principals' Agents' alleged "authority to write policies of insurance for the Insurers" did not extend to executing premium finance contracts for the Insurers.[1]

Case: *CEBV, LLC (as assignee of Ameris Bank) v. ABC HoldCo, Inc.*, Docket No. GLO-L-000856-22 (N.J. Super. 2023)

Issues Discussed: Liability of insurers for losses arising from a fraudulent scheme run by independent insurance agents to misappropriate loans issued by a premium finance company.

Court: New Jersey Superior Court, Law Division

Dates Decided: December 15, 2022 & August 3, 2023

Issue Decided: Insurers did not breach – and were not parties to – premium finance loan contracts entered into by insurance agents, the insurers' policyholders, and premium finance companies.

Submitted by: Fielding E. Huseth, Moore & Van Allen (counsel for one of the defendant-insurers)

[1] On August 3, 2023, the New Jersey Superior Court dismissed without prejudice Plaintiff's claim that the Insurers aided and abetted the alleged violations of NJ RICO and conversion. The Court held that allegations of the Insurers' "mere inaction" (*i.e.*, not responding to the premium finance company's notices) were insufficient to plead aiding and abetting. Plaintiff has not sought to amend the Complaint to replead its aiding-and-abetting claim against the Insurers. Plaintiff's case against the non-Insurer defendants remains ongoing.

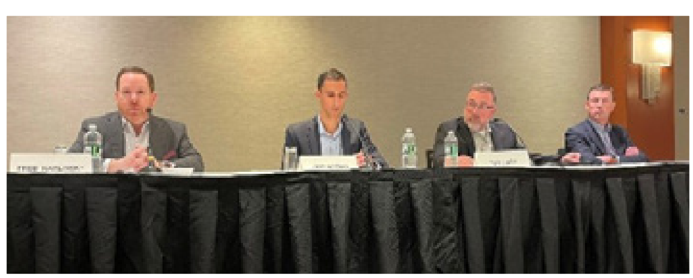
2023 Fall Conference Offered Discussions on Evolving Reinsurance Industry, Arbitration Challenges, AI Ethics and More

On November 9-10, 2023, the members of ARIAS descended upon Midtown Manhattan for the 2023 Fall Conference. Over 265 people attended the conference, which kicked off with a Keynote address by Justice Barry Ostrager, who has now retired and has rejoined ARIAS as a member and certified arbitrator.

After incoming remarks by now-Chair Marc Abrams, who announced the ARIAS Enhanced Membership Fee program, the conference went right into high gear with a fireside chat between long-time ARIAS members and industry luminaries: Bill O'Farrell of Premia Holdings and Brian Snover of Berkshire Hathaway. Bill and Brian entertained and informed the audience with their views on how reinsurance dispute resolution has changed and where it might be going.

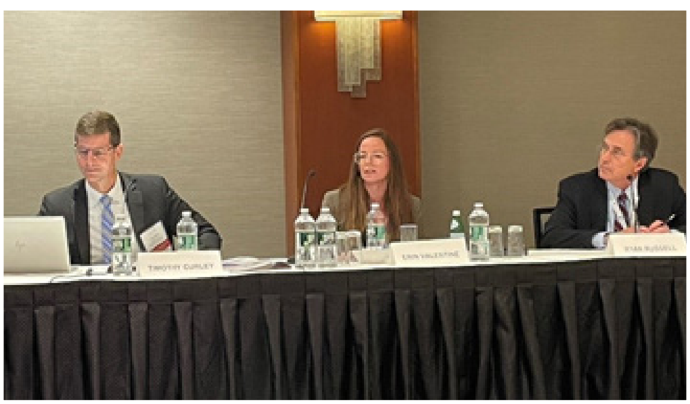
The next general session was a discussion of how the legal landscape for vacating and confirming arbitration awards has changed. Moderated by Suman Chakraborty of Mintz, arbitrator Larry Greengrass, Kristina Matic of Foley, and Erika Lopes-McLeman of Dentons tackled the trials and tribulations of establishing federal jurisdiction on a petition to vacate or confirm.

Following the networking lunch sponsored by Veritext, which included the Member Services Committee Ambassador program lunch, Fred Karlinsky, from Greenberg Traurig, led an interesting panel discussion about the evolving challenges of reinsurance for the property and casualty market. They specifically address natural catastrophes and macro-economic global pressures. Fred was joined by Rob McKenzie of Guy Carpenter, Tom Smith of Partner Re, and Jeff Waters of Moody's RMS.



Following these dynamic general sessions, we broke up into a series of breakout sessions (which were repeated on Friday morning). The breakouts were diverse and thought-provoking. The first and one of the most popular of the breakouts was "Does London Market Reinsurance Cover U.S. "All Sums" Losses?" Moderated by Seema Misra from Arch, the panel included Andrew Poplinger from Chaffetz Lindsey, Christopher Foster from HFW, and arbitrator Bob Hall. The panel provided a cross-border analysis of the Second Circuit's decision in ICSOP v. Equitas.

The second breakout was a discussion of hidden costs and savings opportunities in arbitration between Ryan Russell and Tim Curley of Allianz and Erin Valentine of Chaffetz Lindsey.



Next up was an interesting discussion of where to file suit when there is no arbitration clause in the reinsurance agreement. While this session was for personal jurisdiction geeks, it was made interesting by panelists Chris Hemphill from Cohn Baughman and Janine Panchok-Berry from O'Melviny.

The fourth breakout brought us something different to think about; what happens when a carrier breaks up with its insuretech distributor? As the panel explained, much of today's business is being driven by insure-tech companies and how those contracts are drafted and how to address potential exit strategies are critical to avoiding disputes. The speakers were John Pruitt of Eversheds Sutherland, arbitrator Fred Marziano, and Jonathan Kline from Arch.

Last, but not least, Marc Zimmerman from FTI moderated a panel on the ethical use of AI in insurance and reinsurance. AI is becoming ubiquitous and most companies are jumping in with both feet. The ramifications, however, of using AI in the insurance and reinsurance business are many as the panel explained. The speakers were Avi Gesser of Debevoise, Edward Kelly of Guy Carpenter, Joe Knight from FTI and Cynthia Shoss of Eversheds Sutherland.

After the first round of breakouts, everyone gathered back in the general session room for a robust game of Kahoot in the form of what we called Industry Feud: A New Way to Network. This game was in place of the Membership Services Committee breakout meet and greet and involved teams answering insurance, reinsurance, and ARIAS questions, with the winners taking home Chubb swag. Chubb was kind enough not only to let ARIAS use its Kahoot license but also to provide the technical expertise to run the event.

On Thursday afternoon, ARIAS held its annual meeting and election. ARIAS said goodbye to retiring Board members Cindy Koehler and Steve Schwartz, who were given engraved decanters to remind them of their Board service. A quorum was certified and the members elected new Board members Patricia Taylor Fox from AIG as a Cedent Representative, Neal Moglin from Foley as a Law Firm Representative, both for three-year terms, and re-elected for one-year terms, Alysa Wakin from Odyssey Re as a Reinsurer Representative and Peter Gentile as an Arbitrator Representative.

Following the annual meeting, attendees retired to the ballroom for a cocktail reception where signature drinks were sponsored by Hinshaw, ASW and Saul Ewing.

After some early morning committee meetings, Amy Kline from Saul Ewing moderated a panel on pet peeves in arbitration and whether the biggest complaints are justified. Amy was joined by arbitrators Mark Gurevitz, Sylvia Kaminsky and David Raim, as well as outside counsel Susan Aldridge from Norton Rose, for a lively session.

Following the reprise of the breakouts, the conference concluded with an interesting ethics presentation about how some people try to game the reinsurance arbitration system. Dan FitzMaurice from Day Pitney and Steve Schwartz from Chaffetz Lindsey brought out some good anecdotes of so-called “cheating” and discussed with interaction from the audience whether those behaviors violated the ARIAS Code of Ethics.

All in all, the 2023 Fall Conference was a great success. We can't wait to you see you at the 2024 Spring Conference: "Global Currents: Expanding Arbitration Expertise, Knowledge and Connections." That event will be held at the Fairmont El San Juan Hotel in Puerto Rico, May 1-3, 2024.

ARIAS U.S.

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ARIAS U.S.
2024
SPRING CONFERENCE
May 1-3, 2024
San Juan, Puerto Rico
Puerto Rico
Fairmont El San Juan Hotel PR
$300/night base rate
Early Bird Registration Opens February 20, 2024

Newly Certified Arbitrators

Barry Ostrager

Barry R. Ostrager has served as a New York State Supreme Court Justice in the Commercial Division, retiring on December 31, 2023 after eight-and-a-half years of judicial service. Prior to his appointment to the Bench, Justice Ostrager was a litigation partner at Simpson Thacher & Bartlett LLP and the long-time head of more than 300 attorneys in the Simpson Thacher Litigation Department. Ostrager was, at various points, counsel to Travelers, Chubb, AIG, Swiss Re, SCOR, Lloyd's of London, Fireman's Fund and other insurers. Throughout his professional life, Ostrager was prominently involved in many high-profile commercial cases and was lead trial counsel in many major insurance and reinsurance coverage cases. Ostrager also is co-author of the Handbook on Insurance Coverage Disputes (Wolters Kluwar 2022). The widely-used, three-volume treatise is now in its twenty-first edition and more than 350 courts have cited it. He is also co-author of Modern Reinsurance Law and Practice, 3d. (LegalWorks 2014). Ostrager received his B.A. from City College of the City University of New York in 1968 and his M.A. in 1973. He earned his J.D. from New York University School of Law in 1972 and served as a judicial clerk in the United States District Court for the Southern District of New York.

James Tait

Having previously served as an executive, operational, and financial officer of insurance as well as reinsurance companies, James Tait has hands-on experience with life, health, and property casualty segments of the insurance industry. He has consulted on strategic and financial matters and has been acknowledged as an expert on accounting, auditing, and financial reporting by federal courts, state courts, and various regulatory bodies. He has extensive capital markets experience and has participated as a principal or advisor in more than 300 merger and acquisition transactions. He is trained as a mediator and has served on numerous arbitration panels. He is a certified public accountant and a member of the State of Alabama Bar.

James Liell

James Liell currently serves as vice president & deputy chief legal counsel at SCOR Global Life Americas. In this role since November 2015, he oversees litigation and arbitration, advising on strategic directions for U.S. entities. With a focus on inforce optimization, contract wording, operations, and claims departments, Liell also manages and trains a team of attorneys and paralegals. He previously worked as an Independent Claim & Coverage Counsel in New York; at Everest Reinsurance Company, AI Domestic Claims, Inc., at Home Insurance Company in Liquidation; Mound Cotton Wollan & Greengrass; and Rubin Fiorella & Friedman (formerly Kroll Rubin & Fiorella).

Robert Kuehn

Robert Kuehn is an experienced (re)insurance business executive and attorney. He currently works at RQN Consulting, LLC as a Principal, serving as an advisor in connection with (re)insurance market businesses and practices, inclusive of new business/product development, risk transfer structures (inclusive of captives, ILS and segregated accounts) and underwriting/administrative processes. Kuehn also does advisory with respect to regulatory matters impacting U.S. and international transactions and markets. He previously worked at: Deans & Homer, Siriuspoint, LTD., Converium Reinsurance, American International Group, and at Mendes & Mount, LLP. He received his Juris Doctorate at St. John's University School Law, and he is a member of the New York State Bar, admitted SDNY and EDNY.

Newly Qualified Mediator

Peter Nahmias

Peter Nahmias is the founder and principal of Nahmias Dispute Resolution, which provides, arbitration and mediation as well as facilitation and one-to-one coaching for intra-business organization dispute resolution. Peter has been in international legal practice for over 30 years, in big firm, multinational in-house and private practice settings. He is dual-qualified as both a civil law and common law attorney in the US (NY, NJ) and Madrid, Spain. He has direct experience counseling highly regulated and controversial consumer goods companies (chemicals, alcohol, tobacco, etc) and has managed tort liability and contract litigation and dispute resolution globally. His professional designations include ARIAS Certified Mediator and Fellow of the Chartered Institute of Arbitrators (CIArb).

ARIAS ·U.S. 2024 Board of Directors Welcomes Two New Members

At the ARIAS Annual Meeting on November 9, 2023, two new Board members were elected for a three-year term, and two existing Board members were re-elected for a one-year term.

The new Board members are:

Patricia Taylor Fox, AIG, assuming one of the Ceding Company seats

Neal Moglin, Foley & Lardner, assuming one of the Law Firm seats.

Patricia Taylor Fox and Neal Moglin are replacing Cindy Koehler and Steve Schwartz, whose terms expired.

Re-elected were:

Alysa Wakin, Odyssey Re, in one of the Reinsurer seats

Peter Gentile, in one of the Arbitrator seats.

ARIAS thanks Cindy and Steve for all their service on the Board and welcomes Trish and Neal.

UPCOMING EVENTS

Spring Conference

May 1-3, 2024

Fairmont El San Juan Hotel PR
San Juan, Puerto Rico

UPCOMING SEMINARS AND WORKSHOPS

2024 March Educational Workshop

Bankruptcy, Insolvencies, and (Re)insurance: What We Need To Know and Why You Should Care

March 5, 2024 – 12:30 pm – 4:00 pm

Saul Ewing LLP
Centre Square West
1500 Market Street, 38th Floor
Philadelphia, PA 19102-2186

2024 Intensive Arbitrator Workshop

April 30, 2024

Fairmont El San Juan Hotel

2024 Umpire Masterclass

November 13, 2024

New York Hilton, Midtown

UPCOMING WEBINARS

ARIAS Legal Update 2024: *A Discussion of Significant Insurance and Reinsurance Cases from 2022 and 2023*

February 27, 2024 – 1:00 p.m. – 2:00 pm Eastern

Advice for Arbitrators from Arbitrators

April 5, 2024 – 1:00 p.m. – 2:00 p.m. Eastern

BOARD OF DIRECTORS

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ARIAS U.S.

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