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New York's High Court Delivers a Blow to the Bellefonte Cap

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Hinshaw Alert

On December 14, 2017, the New York Court of Appeals issued a unanimous decision in *Global Reinsurance Corporation of America v. Century Indemnity Co*. in which it answered a certified question from the United States Court of Appeals for the Second Circuit and delivered a blow to the Bellefonte cap that served as "a star to steer by" for many courts over the past quarter of a century.

In an August 2016 article for Best's Review, Hinshaw & Culbertson's Scott Seaman and Ed Lenci examined the *Bellefonte* cap in detail and set the stage for yesterday's Court of Appeals decision. The *Bellefonte* Cap Returns.

The issue of whether the limits of a facultative certificate capped the reinsurers liability for both loss and expense was squarely presented in the *Global Re* case. Rather than decide the issue outright as it had in 1990 in *Bellefonte* or later in *Unigard v. North River*, the Second Circuit sought input from New York's high court.

In December, 2016, the Second Circuit certified the following question to the New York Court of Appeals: "Does the decision of the New York Court of Appeals in [*Excess Insurance Co. Ltd. v Factory Mutual Insurance Co*. 3 NY3d 577 (2004)] impose either a rule of construction, or a strong presumption, that a per occurrence liability cap in a reinsurance contract limits the total reinsurance available under the contract to the amount of the cap regardless of whether the underlying policy is understood to cover expenses such as, for instance, defense costs?" *Global Reinsurance Corporation of America v. Century Indemnity Co.*, 843 F.3d 120, 128 (2d Cir 2017).

In its December 14, 2017 decision, the court said it now answers "the certified question in the negative. Under New York law generally, and in *Excess* in particular, there is neither a rule of construction nor a presumption that a per occurrence liability limitation in a reinsurance contract caps all obligations of the reinsurer, such as payments made to reimburse the reinsured's defense costs."

Though not always followed by courts and frequently rejected by arbitration panels in confidential reinsurance arbitrations, *Bellefonte* emerged as the leading decision over the past 27 years. The Court of Appeals in *Global Re* acknowledged that some other decisions have read *Excess* (a New Court of Appeals decision following *Bellefonte*) as establishing a rule that the

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reinsurance limits of a facultative certificate capped both loss and expense. It stated starkly that "[w]e now dispel any intimation that *Excess* established such a rule." The Court of Appeals noted that, in *Excess,* the court was simply not faced with the question of whether there is a blanket "presumption" or "rule of construction" that a limitation on liability clause applies to all payments by a reinsurer. Consequently, *Excess* did not pass on whether a follow form clause such as the one in that case, "subject[ing]" the reinsurance "to the same valuation, clauses and conditions as contained in the original policy," would require the reinsurers to cover third-party defense costs in excess of such a limit. The court further distinguished *Excess*, noting in *Excess* "the loss adjustment expenses were incurred in litigation between the insurer and its policyholder; they were not costs (such as third-party defense costs) that the insurer was obligated to pay under the terms of the underlying policy itself. Whether a similar (or even identical) limitation clause would apply to third-party defense costs, in a certificate reinsuring a liability insurance policy, was never at issue."

The Court of Appeal pointed out reinsurance contracts should be "read as a whole, and every part will be interpreted with reference to the whole." Particularly where an agreement is "negotiated between sophisticated, counseled business people negotiating at arms' length, . . . courts should be extremely reluctant to interpret an agreement as impliedly stating something which the parties have neglected to specifically include. Also, it stated that courts should be mindful that the certificate, while serving as written confirmation of a contract, might not in and of itself constitute the fully integrated agreement. It cited to its decision in *Union Carbide* for the proposition that, where reinsurance policy incorporates underlying policy, the underlying policy is not considered extrinsic evidence. Like any contract, a facultative reinsurance contract "that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms."

According to the New York high court, rather than "adopting a blanket rule, based on policy concerns," a court must "look to the language of the policy" above all else. It noted in the insurance context, its jurisprudence confirms that even modest variations on the face of a written agreement can alter the meaning of a critical term. It pointed out that a court is not permitted to disregard the precise terminology that the parties used and simply assume, based on its own familiar notions of economic efficiency, that any clause bearing the generic marker of a "limitation on liability" or "reinsurance accepted" clause was intended to be cost-inclusive. Therefore, New York law does not impose either a rule, or a presumption, that a limitation on liability clause necessarily caps all obligations owed by a reinsurer, such as defense costs, without regard for the specific language employed. The court emphasized that its decision is limited to answering the narrow question certified.

The case now returns to the Second Circuit for further proceedings with the benefit of the New York high court's answer to the certified question. By way of background on this case, in June 2015, the United States District Court for the Southern District of New York granted Global Re summary judgment, ruling that the reinsurance accepted limit capped the facultative reinsurer's liability for loss and expense combined. The Second Circuit panel seemed skeptical about the *Bellefonte* conclusion that the facultative certificate language unambiguously capped liability for both loss and expense and suggested that industry custom and usage might shed light on the issue. Yet, the Second Circuit recognized the importance of *stare decisis* and, thus, decided to certify the issue it framed. In certifying the issue, the Second Circuit stated that if *Excess* imposes a clear rule or a presumption with respect to these reinsurance certificates, the rule would guide our interpretation of this and substantially similar certificates. "If, on the other hand, the standard rules of contract interpretation apply, we would construe each reinsurance policy solely in light of its language and, to the extent helpful, specific context." In the wake of the Court of Appeal's decision and in view of the Second Circuit panel's discussion in the decision certifying the question, the parties may find themselves disclosing experts and adducing evidence of industry custom and usage on remand.

The *Bellefonte* cap was controversial from the outset and has taken some recent hits. The Second Circuit itself declined to apply the *Bellefonte* cap in its *Utica Re v. Munich Re* decision by distinguishing the contract language and a recent Pennsylvania appellate court decision declined to follow *Bellefonte*.

From a ceding company perspective, the New York Court of Appeal's decision in *Global Re* will be viewed favorably and likely characterized as the death knell of the *Bellefonte* cap. Reinsurers likely will argue that this was a narrow decision and emphasize that the language in their certificates compels the conclusion reached by the district court that the

reinsurance accepted limit capped the facultative reinsurer's liability for loss and expense combined. In view of the language of the decision, reinsurers are likely to maintain that the *Bellefonte* Cap applies with full force to declaratory judgment costs.

The New York Court of Appeal's approach is hardly surprising. The court has been consistent in recent years in focusing on specific contract language in resolving insurance and reinsurance disputes, rather than relying upon public policy considerations or applying general pronouncements in prior cases as hard and fast rules. It took this approach in *Viking Pump* holding that non-cumulation clauses warranted a departure from general principles of *pro rata* allocation set forth in *Consolidated Edison*. It also took this approach in the *Selective Insurance Co.* case on the issue of number of occurrences, distinguishing the language there from the language involved in *Appalachian v. General Electric*.

One thing appears certain – we have not yet heard the last word on the *Bellefonte* cap.

For further information, please contact Scott Seaman.