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Alerts

The Latest Decision in the Global Re Case

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Insights for Insurers

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The *Bellefonte* Cap

The Bellefonte Cap is a shorthand reference to the "reinsurance accepted" limit set forth in a facultative certificate generally capping the reinsurer's obligations with respect to loss and expense combined. It stems from the 1990 Second Circuit decision in *Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co*., which was followed by many courts in various jurisdiction for more than a quarter of a century. The decision, however, was not universally followed by courts and was criticized by many commentators. *See generally, The Bellefonte Cap Returns, A.M. Best's Review, August 2016.*

The *Global Re* case has eliminated any presumption of the Bellefonte cap under New York law. *Global Re* has produced multiple written opinions, but we focus on the two key decisions in this alert. First, we briefly review the seminal decision of from the New York Court of Appeals that provided the controlling standard for determining the treatment of expenses under facultative certificates under New York law. Next, we examine this week's decision of the Southern District of New York rendered after the court conducted an evidentiary hearing on remand. As detailed below, the court ruled that the stated limit in the facultative certificates capped losses and also capped expenses where there are no losses. It did not cap expenses where there are losses.

The Prior New York Court Of Appeal's Decision

As we previously reported, on December 14, 2017, the New York Court of Appeals issued a unanimous decision in *Global Reinsurance Corporation of America v. Century Indemnity Co*. which answered a certified question from the United States Court of Appeals for the Second Circuit and delivered a blow to the Bellefonte cap. In answering the certified question, the New York Court of Appeals stated, under New York law "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."

The Court of Appeals 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 a reinsurance policy incorporates an 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 Recent Decision From The Southern District Of New York

Earlier this week, the sixth decision in this saga was issued by the United States District Court for the Southern District of New York. *Global Reinsurance Corp. of America v. Century Indemnity Co.*, No. 13 Civ. 6577 (LGS) (S.D.N.Y. Mar. 2, 2020). The court, on remand, conducted an evidentiary hearing and looked to traditional rules of contract interpretation to construe the facultative certificate.

The court denied the reinsurer's request for declaratory relief and held that, pursuant to the plain and unambiguous meaning of the facultative certificates, the stated limit capped losses and it also capped expenses where there are no losses. It did not, however, cap expenses where there are losses.

The court referred to various terms in the facultative certificate, including:

- the preamble to the certificates (. . . "subject to the terms, conditions and limits of liability set forth herein and in the Declarations made a part hereof, the Reinsurer does herby reinsure the ceding company . . . in respect of the Company's policy(ies) as follows:").
- Item 4 of the Declarations, the "Reinsurance Accepted" dollar amount, identifying the layer and participation of the reinsurance.
- The following form clause that provides: "The liability of the Reinsurer, as specified in Item 4 of the Declarations, shall follow that of the Company and shall be subject in all respects to all the terms and conditions of the Company's policy except when otherwise specified provided herein or designated as non-concurrent reinsurance in the Declarations."
- The payment provision provides: "All loss settlements made by the Company, provided they are within the terms and conditions of the original policy(ies) and within the terms and conditions of the certificate of reinsurance, shall be binding on the Reinsurer. Upon receipt of a definitive statement of loss, the Reinsurer shall promptly pay its proportion of such loss as set forth in the Declarations. In addition thereto, the Reinsurer shall pay its proportion of expenses [agreed by the parties in this case to include defense costs] . . . incurred by the Company in the investigation and settlement of claims or suits and its proportion of court costs and interest on any judgment or award, in the ratio that the Reinsurer's loss payment bears to the Company's gross loss payment. If there is no loss payment, the Reinsurer shall pay its proportion of such expenses only in respect of business accepted on a contributing excess basis and then only in the percentage stated in Item 4 of the declarations in the first layer of participation.

In support of its position, the ceding company, Century, submitted four expert witnesses. The reinsurer, Global Re, submitted two experts. The Century experts opined the certificates were drafted so that the terms and conditions of the underlying insurance were the same as or "concurrent" with the reinsurance as reflected by the "Following Form" clause and "Payments Provision." They opined that concurrency was essential to facultative certificates. Since their origin in the European marine markets were documented through placement slips, insurers would not bear the risk of non-concurrent expenses. The Global Re experts testified that the only limit is stated in Item 4, and the precise dollar amount does not distinguish between losses and expenses. Thus, it limits losses and expenses combined. They maintained there was no

widespread understanding in the 1970s about the central importance of concurrency. Claims generating substantial expenses above the reinsurance accepted limits had not yet emerged in the insurance/reinsurance industry. Therefore there was no basis for any industry custom and practice to develop as to concurrency of reinsurers' liability for expenses.

The parties' experts also disagreed about the proper interpretation of the reinsurance text. As to the Following Form clause, the Global Re experts stated the clause addresses only the types of risk coverage, not the liability limit. But even if the clause also addresses limits, the Global Re experts contended that the Preamble expressly provides that expenses are non-concurrent by stating that the reinsurance is "subject to" the stated limits. The Global Re experts also stressed that, just because the Payments Provision states that certain expenses must be paid on a proportional basis does not mean those expenses are not capped. In contrast, the Century experts opined that the Preamble and its phrase "subject to" do not refer solely to the terms, conditions and limits stated on the reinsurance certificate, but instead to all of the terms, conditions and limits governing the integrated reinsurance agreement—*i.e.*, also the terms of the underlying Century policies, including the Supplementary Payments provision, which states that the insurer must pay expenses in addition to the limit of liability. The Century experts also testified that the two dollar amounts stated in Item 4 establish a ratio, which knowledgeable members of the reinsurance industry would recognize due to the phrase "part of."

To determine whether the certificates were ambiguous, the court reasoned it first had to identify the "the fully integrated contract." It concluded the underlying insurance policies the ceding company issued by its insured (the reinsured contracts) were integral to the reinsurance contracts because the facultative certificates referenced and incorporated those underlying policies. Accordingly, the court held that it could review the underlying contracts together with the certificates to determine, as a whole, whether the certificates were ambiguous.

The court deemed that the relevant inquiry was whether the reinsurance contract's terms could suggest more than one meaning to a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages, and terminology as generally understood in the reinsurance and insurance industries during the applicable time. The opinion states that, although the ceding company and reinsurer agreed that the certificates were unambiguous, they disagreed as to their meaning. The court stated that each party overstated its arguments, ignoring or misconstruing the explicit text in the certificates.

The court found that "[t]he plain and unambiguous meaning of the reinsurance contracts is that the dollar amount stated in Item 4 caps [the reinsurer's] obligation to pay losses and also caps [the reinsurer's] obligation to pay expenses when there are no losses, but does not cap [the reinsurer's] obligation to pay expenses when there are losses." The court's interpretation was based on the language of the certificate, after having read the certificate as a whole and with reference to the customs, practices, usages and terminology understood in the industry in the 1970s.

The court focused on the Following Form clause, finding if refers not only to the types of risks covered, but instead to all the terms and conditions, including the Supplementary Payments provisions in the underlying policies, which are defense-costs-in-addition-to-limits provisions. The court also noted that the Payments Provision provided that the reinsurer must pay all loss settlements in proportion of expenses. Based on its parsing of the relevant provisions, and with consideration of expert testimony, the court concluded that the amount the reinsurer must pay is limited when there are no loss payments, with the cap being the same as the cap on indemnity payments, but when there are losses the reinsurer must pay for expenses based on a proportionate share of the losses. The court largely accepted the concurrency opinions of the Century experts.

Conclusion

The *Global Re* decision represents a victory for the ceding company in this case. The Bellefonte cap presumption still may apply where New York law is not controlling. Even where New York law is controlling, *Global Re* does not create a presumption or conclusive determination that expenses are not within the reinsurance accepted limits. Rather, the particular language of the facultative certificate must be considered and may warrant a different conclusion. Further, it is possible for other courts—even applying New York law—to conduct evidentiary hearings in which different evidence and expert opinion are adduced and different conclusions are reached. Given the history of this case, this may not be the final decision in this matter. This certainly is not the final word on the Bellefonte cap.