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# Recent Court Decisions that Impact the Resolution of Insurance and Reinsurance Disputes: The Continued Rise Of The New York Convention And The Fall Of The "*Bellefonte* Cap."

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*Insights for Insurers*


## Attorneys

Edward K. Lenci


## Another Circuit Court Holds That the New York Convention Pre-empts State Laws Prohibiting Arbitration of Insurance Disputes

On August 12, 2021, the U.S. Court of Appeals for the Ninth Circuit held that Article II, Section 3, of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (commonly known as the New York Convention), which obligates signatory nations to enforce agreements to arbitrate that fall under the Convention, preempts state insurance laws that preclude the arbitration of insurance disputes and/or prohibit the inclusion of mandatory arbitral provisions in insurance policies. *CLMS Mgmt. Servs. Limited P'ship, et al. v. Amwins Brokerage of Georgia LLC, et al*. With this decision, the Ninth Circuit has joined the U.S. Courts of Appeals for the Fourth and Fifth Circuits on this point of law. Conversely, the U.S. Courts of Appeals for the Second and Eighth Circuits have held that the Convention does not override state insurance laws.

In *CLMS*, plaintiffs, the owners of a townhouse complex in the State of Washington, had an insurance policy, through defendant Amwins Brokerage of Ga., LLC, that was underwritten by Certain Underwriters at Lloyd's. Plaintiffs sued for coverage of losses under the policy arising from Hurricane Harvey. The insurers moved to compel arbitration pursuant to the arbitral provisions of the policy, which stated in relevant part as follows:

> All matters in difference between the Insured and the Companies (hereinafter referred to as "the parties") in relation to this insurance, including its formation and validity, and whether arising during or after the period of this insurance, shall be referred to an Arbitration Tribunal in the matter hereinafter set out ….
>
> The seat of the Arbitration shall be in New York and the Arbitration Tribunal shall apply the law of New York as the proper law of this insurance. …

The federal district court granted the motion to compel arbitration.

This was a case of first impression for the Ninth Circuit. The court recognized at the outset that "[t]his appeal presents an issue that … lies at the intersection of international, federal, and state law: whether the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15, allows a Washington statute to reverse-preempt the [New York Convention], a multilateral treaty." The McCarran-Ferguson Act, a federal statute, gives states the authority to regulate the business of insurance. The state statute in question, Wash. Rev. Code § 48.18.200, provided in relevant part:

> (1) … [N]o insurance contract delivered or issued for delivery in this state and covering subjects located, resident, or to be performed in this state, shall contain any condition, stipulation, or agreement . . .
>
> > (b) depriving the courts of this state of the jurisdiction of action against the insurer . . .
>
> (2) Any such condition, stipulation, or agreement in violation of this section shall be void, but such voiding shall not affect the validity of the other provisions of the contract.

Even though there is implementing legislation for the Convention in Chapter 2 of the Federal Arbitration Act, at 9 U.S.C. § 201, *et seq*., the Ninth Circuit concluded "that the relevant provision of the Convention is self-executing, and therefore not an 'Act of Congress' subject to reverse-preemption by the McCarran-Ferguson Act." A self-executing treaty or a self-executing provision of a treaty, "'automatically [has] effect as domestic law[.]' *Medellin v. Texas*, 552 U.S. 491, 504, 128 S. Ct. 1346, 170 L. Ed. 2d 190 (2008)."

## News of the Death of the "Bellefonte Cap" May Not Be Exaggerated

What is often called the *Bellefonte* Cap stemmed from a 1990 decision of the U.S. Court of Appeals for the Second Circuit in *Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co*. There, the Second Circuit held that a cedent's declaratory judgment costs, *i.e.,* expenses associated with litigating coverage issues with direct policyholders, were capped by a reinsurance contract's—particularly a facultative certificate's—limits of liability. The Second Circuit's decision was long considered to apply regardless of the language of a reinsurance contract.

Then, in 2018, the *Global Reinsurance Corp. of Am. v. Century Indem. Co*. the Second Circuit, based on the answer of New York State's Court of Appeals to a certified question that there is no hard and fast rule of law, reversed the district court, which had applied the Cap rotely. The Second Circuit remanded for consideration of the terms of the particular contract at issue, employing standard principles of contract interpretation. On remand, the district court, based on the contractual terms and conditions and substantial expert testimony, found for that "the plain and unambiguous meaning of the reinsurance contracts at issue in this case is that Item 4 [of the certificates] caps losses, and also caps expenses when there are no losses, but does not cap expenses when there are losses."

On July 29, 2021, the Second Circuit, in *Utica Mut. Ins. Co. v. Munich Reinsurance Am.*, examined the language of the ceding policy and the facultative certificates to reach an outcome in favor of the reinsurers, but without any mention of *Bellefonte*. Significantly, the Second Circuit began its analysis of the first issue with the recitation of foundational rules of contractual interpretation. For example, an umbrella policy and certificates are construed like any ordinary contract; a contract that is complete, clear, and unambiguous on its face must be enforced according to the plain meaning of its terms; if a contract, read as a whole, is reasonably susceptible of only one meaning, a court may not alter it; and whether a contract is ambiguous is a question of law, as is the meaning of an unambiguous contract. This is consistent with the answer of the New York Court of Appeals in *Global Re*.

The Second Circuit held for the reinsurers on two grounds:

> The 2007 settlement treated the 1973 umbrella policy as paying defense costs within limits (specifically, "[t]he payment by Utica Mutual of Defense Costs and allocation of such Defense Costs to a particular … Umbrella Policy Period will erode that Policy Period's Unimpaired Limits")…. This settlement term contradicts [the cedent]'s present contention that the reinsurers must reimburse defense costs in addition to the umbrella policy limits. On the settlement's own terms, [the cedent]'s allocation is invalid.

> [The cedent]'s argument fails on another front. Its allocation, irrespective of what the 2007 settlement authorized, is outside the terms of the 1973 umbrella policy. *Fireman's Fund*, 957 F.3d at 348. The umbrella policy, as we hold above, covers defense costs within limits on the asbestos claims. The [reinsurers'] certificates reinsure the same because they have "follow form" clauses. These clauses link the reinsurers' liabilities to [the cedent]'s obligation under the umbrella policy, meaning their liabilities must track [the cedent]'s. See *id*. at 341; *Clearwater*, 906 F.3d at 15; see also *Glob. Reinsurance*, 30 N.Y.3d at 513 ("[I]n facultative reinsurance, the reinsurer agrees to indemnify the cedent for all or a portion of the cedent's risk under a single policy in the event of a loss.").
>
> The certificates incorporate the obligation to pay defense costs within the stated limits on the asbestos coverage, not in addition. [The reinsurers] "cannot be held accountable for an allocation that is contrary to [this] express language" in their reinsurance policies. *Fireman's Fund*, 957 F.3d at 347; see also *U.S. Fid. & Guar. Co. v. Am. Re-Ins. Co*., 20 N. Y.3d 407, 420, 985 N.E.2d 876, 962 N.Y.S.2d 566 (2013) ("[A] follow the settlements clause 'does not alter the terms or override the language of reinsurance policies.'" (quoting *Travelers Cas. & Sur. Co. v. Certain Underwriters at Lloyd's of London*, 96 N.Y.2d 583, 596- 97, 760 N.E.2d 319, 734 N.Y.S.2d 531 (2001)). "It is well-established and not at all surprising that follow-the-fortunes does not require indemnification for losses not covered by the underlying policies." *Gerling*, 419 F.3d at 193.
>
> We hold, therefore, that the 2007 settlement agreement with [the policyholder] does not independently require [either reinsurer] to pay defense costs in addition to limits.

The Cap as a legal principle is no more, at least in New York State and the Second Circuit. The message is now clear: contractual language matters. Cedents and reinsurers alike are well-served by expressly addressing the treatment of expenses at the time of placement and by making sure the language comports with the desired result. Furthermore, the parties must carefully consider, again at the time of placement, the manner of resolution (*i.e*., arbitration or litigation) and choice of law. If arbitration is preferred, relying on off-the-clause arbitral provisions, some decades old, is a problem waiting to occur. Typically, the arbitral provisions of reinsurance contracts require the panel to treat the reinsurance contract as an "honorable engagement" and allows them to ignore applicable law. While that does not give the panel permission to re-write the parties' agreements, obtaining *vacatur* of an arbitral award is akin to hitting a home run in a hurricane.

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*CLMS Mgmt. Servs. Limited P'ship, et al. v. Amwins Brokerage of Georgia LLC, et al*., 2021 U.S. App. LEXIS 23996 (9th Cir. August 12, 2021).

*Safety Nat'l Cas. Corp. v. Certain Underwriters at Lloyd's, London*, 587 F.3d 714, 717 (5th Cir. 2009); *ESAB Grp. v. Zurich Ins*., 685 F.3d 376, 380 (4th Cir. 2012)

*Stephens v. American International Insurance Co*., 66 F.3d 41 (2d Cir. 1995); *Safety National Casualty Corp. v. Certain Underwriters at Lloyd's, London*, 587 F.3d 714 (5th Cir. 2009) (*en banc*), *cert. denied,* 131 S.Ct. 65 (2010).

*Bellefonte Reinsurance Co. v. Aetna Casualty & Sur. Co*., 903 F.2d 910 (2d Cir. 1990).

*Global Reinsurance Corp. of Am. v. Century Indem. Co*., 890 F.3d 74 (2d Cir. 2018).

*Global Reinsurance Corp. of Am. v. Century Indem. Co*., 30 N.Y.3d 508, 69 N.Y.S.3d 207 (N.Y. 2017).

*Global Reinsurance Corp. of Am. v. Century Indem*. Co., 442 F. Supp. 3d 576, 592 (S.D.N.Y. 2020).

*Utica Mut. Ins. Co. v. Munich Reinsurance Am*., 2021 U.S. App. LEXIS 22476, 2021 WL 3197017 (2d Cir. July 29, 2021).

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