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Alerts

The Bell Tolls for the "*Bellefonte* Cap"

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Insights for Insurers

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In 2016, *Best's Review* published our article titled "The Bellefonte Cap Returns.
" As we explained, the Cap stemmed from the decision of the U.S. Court of Appeals for the Second Circuit in 1990 in *Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co*. In *Bellefonte*, 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. At the time we published our article, the Cap seemed alive and well, though still controversial. The occasion for our article was oral argument in a case in Second Circuit, *Global Reinsurance Corp. of America v. Century Indemnity Co*.

Now, over five years later, the Second Circuit has laid the Cap to rest. On December 28, 2021, in the same dispute between Global Re and Century, the Second Circuit unequivocally stated that the *Bellefonte* Cap "no longer constitute[s] the law of our circuit." The Cap "'is no longer good law[.]'"

It was a long and winding road to the Cap's final resting place. In 2018, the Second Circuit, based on the answer of the New York 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, and 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 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. "

In the decision handed down on December 28, 2021, the Second Circuit affirmed the district court's decision, burying without praise its prior precedent. Of particular note is the Second Circuit's discussion of the expert testimony both sides submitted in the district court. Here is one passage:

> [Our] conclusion finds support not only in the unambiguous language of the certificates but also in the credible "testimony regarding the relevant industry custom and practice" that Century's experts provided to the district court. *Global VI*, 442 F. Supp. 3d at 590. One expert testified that "during the 1970s and thereafter, it was the invariable custom and practice of the insurance and reinsurance industry" that "unless otherwise specifically stated, facultative reinsurance certificates covered investigation and defense expense in addition to limits of liability when the

> reinsured policy covered expense in addition to its limits of liability." J. App'x 289 (Hall Statement ¶ 2). The expert further testified that "[w]hile non-[con]currency between the facultative certificate and the reinsured policy" was "possible," it was "rare," and thus "[t]o overcome the textual presumption of [con]currency stated in the following form provision," it was necessary "clearly and explicitly" both to "state the non-concurrency" and to "define the nature of the non-concurrency." J. App'x 295 (Hall Statement ¶ 20). According to this expert, such non-concurrency would be indicated "by endorsement" or "by checking the 'Non-Concurrent' box on the form certificate and specifically stating the non-concurrency elsewhere on the form." Id. But a statement of non-concurrency would not, as Global insists, be found "in the wording of the certificate form itself." *Id*.; *see also id*. at 380 (Thomson Statement ¶ 12) ("The Reinsurance Accepted provision is not a provision that is used to identify a non-concurrency.").
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> Because non-concurrency "would … be specifically identified and negotiated," the expert maintained that "neither the 'subject to' phrase in the certificates' preamble nor the dollar amount set forth in the certificate's 'Reinsurance Accepted' provision would have been understood in the industry to provide … a specific exception [to the presumption of concurrency] or an overall 'cap' on the reinsurer's exposure." *Id*. at 289, 295 (Hall Statement ¶¶ 2, 20). The other Century experts agreed. *See id*. at 347 (Manning Statement ¶ 45) ("Any knowledgeable and experienced insurance or reinsurance underwriter would understand that the fact that the reinsurance is 'subject to' the limits does not tell you whether expenses are payable in addition to limits, within limits or not at all."); *id*. at 360 (Lyew Statement ¶ 28) ("[T]here is no language in the certificates that would be understood by a reinsurance underwriter to identify a reinsurance limit or cap without regard to the manner in which the reinsured policy applies."); *id.* at 380 (Thomson Statement ¶ 13) ("[T]he Reinsurance Accepted provision [does not establish non-concurrency with respect to defense costs] as it is silent as to whether the amount of assumed reinsurance is cost-inclusive or cost-exclusive.").

The Second Circuit added that:

> The Century experts offered another, perhaps even more fundamental, reason why the reinsurance industry operates under a presumption of concurrency. As Century's experts explained, "[i]t is well known and universally understood in the insurance and reinsurance industry that 'premium follows risk,'" *id*. at 306 (Hall Statement ¶ 58), meaning that "whoever takes the risk will get the premium for it," id. at 346 (Manning Statement ¶ 40). This principle requires concurrency as to the treatment of defense costs because otherwise, as one expert explained, the cedent "would be left with gaps in coverage and it would potentially end up keeping risk for its own account even though it had paid reinsurers all of the premium associated with that risk." *Id*. at 300-01 (Hall Statement ¶ 37). The market would not be able to sustain such a "disparity in exposure" between cedents and their reinsurers: "[n]o ceding company would accept [such] gaps in coverage while at the same time paying full premium to the reinsurers," "[o]ther reinsurers on the same layer would never accept more exposure for the same premium as received by one reinsurer for less exposure," and "insurers would not buy coverage with that sort of gap." Id. at 306 (Hall Statement ¶ 56). It is therefore unsurprising that in the district court proceedings, "neither Global, its fact witnesses nor its expert witnesses [could] identif[y] any … instance in which any reinsurer, pre-Bellefonte, asserted the position that Global takes in this case." *Id*. at 382 (Thomson statement ¶ 18).

However, it is important to understand that the Second Circuit's decision simply means that one size does fit all. After all, 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.

The lesson of this odyssey is that ceding companies 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. Indeed, many reinsurance contracts of more recent vintage contain updated or different language from that traditionally found in facultative certificates.

Parties must carefully consider 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-self arbitral provisions, some decades old, is a problem waiting to occur because, 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. Although this 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 against hurricane-force winds.

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

Global Reinsurance Corp. of Am. v. Century Indem. Co., No. 20-1476, at pp. 6 & 23 (2d Cir. Dec. 28, 2021) (citations omitted) ("2021 Opinion").

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).

2021 Opinion at 28-29.

Id., at 29-30.

Utica Mut. Ins. Co. v. Munich Reinsurance Am., 7 F.4th 50 (2d Cir. 2021).

The decision in *Utica Mutual* is discussed at length in E. Lenci, "The Continued Rise Of The New York Convention And The Fall Of The '*Bellefonte* Cap,'" *Arbitrate.com*, Sept. 8, 2021 (https://arbitrate.com/the-continued-rise-of-the-new-york-convention-and-the-fall-of-the-bellefonte-cap/ (originally published by Hinshaw's *Insights for Insurers*, August 20, 2021)).