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Larry P. Schiffer
Editor

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Reinsurance Newsletter

Recent Case Summaries

Fifth Circuit, *en banc*, Holds That Louisiana Anti-Arbitration Law Through the McCarran-Ferguson Act Does Not Reverse Preempt New York Convention

Safety Nat'l Cas. Corp. v. Certain Underwriters at Lloyd's, London, No. 06-30262, 2009 U.S. App. LEXIS 24585 (5th Cir. Nov. 9, 2009).

In a reinsurance dispute in which a motion to compel arbitration was denied, the Fifth Circuit Court of Appeals, *en banc*, reversed and held that the McCarran-Ferguson Act does not reverse preempt application of the Convention on the Recognition and Enforcement of Foreign

Arbitral Awards (the “New York Convention”). We reported on this case in our December 2008 Reinsurance Newsletter. The underlying dispute arises out of a workers’ compensation self-insured fund that obtained excess-of-loss reinsurance for amounts that exceeded the fund’s self-insured retention. The fund entered into a loss portfolio transfer agreement with another workers’ compensation carrier, but the reinsurer refused to recognize the assignment.

The dispute found its way into federal court where the reinsurer moved to stay the litigation and compel arbitration. The fund sought to quash the arbitration claiming that the arbitration agreements were not enforceable under Louisiana law.

Although the district court initially granted the motion to compel arbitration, it reversed itself and held that the McCarran-Ferguson Act reverse-preempted the New York Convention and precluded arbitration. The district court was reversed by the Fifth Circuit, but that panel’s decision was vacated for the entire circuit court to hear the appeal *en banc*.

In reviewing the appeal *en banc*, the circuit court held that the McCarran-Ferguson Act did not apply to the New York Convention because it was not an act of Congress as meant by McCarran-Ferguson, and that the New York Convention, as a treaty, superseded state law. Because Louisiana law, as interpreted by Louisiana courts, conflicts with the United States’ commitments under the New

York Convention, it is superseded. The court held that it was “untenable” that Congress intended in the McCarran-Ferguson Act to exclude self-executing treaties, but to include under its preemption umbrella treaties that are implemented by federal legislation.

This case provides a detailed analysis of McCarran-Ferguson, and the workings of the New York Convention and its enabling legislation. This court held that the enabling legislation, which enforces the New York Convention, is not an act of Congress for preemption purposes under McCarran-Ferguson. The majority notes that its decision conflicts with that of the Second Circuit in *Stephens v. Am. Int’l Ins. Co.*, 66 F.3d 41 (2d Cir. 1995). The majority opinion was followed by a concurrence and a lengthy and detailed dissent (three judges dissenting). It will be interesting to see if the case finds itself before the United States Supreme Court for clarification of this important international dispute resolution issue.

Third Circuit Confirms Decision to Compel Arbitration and to Uphold Arbitration Award Based on Incorporation by Reference of Arbitration Clause

Century Indemn. Co. v. Certain Underwriters at Lloyd’s, London, No. 08-2924, 2009 U.S. App. LEXIS 22619 (3d Cir. Oct. 15, 2009).

In a decision following the granting of a motion to compel arbitration and the denying of a motion to vacate the subsequent arbitration award based on the incorporation by reference of an arbitration agreement, the Third Circuit Court of Appeals has upheld both decisions of the district court. The case arises from a dispute between a retrocedent and retrocessionaire over three retrocessional agreements covering the business ceded on an excess-of-loss basis by the original cedent, which in turn provided insurance to asbestos distributors. The basis of the dispute is the cession of declaratory judgment expenses.

After the retrocedent commenced suit to recover the declaratory expenses it paid to its cedent, the retrocessionaire claimed that the dispute was subject to arbitration because the retrocessional contracts incorporated by reference the arbitration provisions of the original reinsurance contracts. The district court granted the retrocessionaire’s motion to compel arbitration based on the incorporation theory. The arbitration proceeded and the panel excluded evidence of industry custom and the parties’ course of dealings based on the unambiguous contract language and the irrelevancy of the evidence. A majority award was issued in favor of the retrocessionaire. The retrocedent moved to vacate the award, which was

denied by the district court. This appeal followed.

In upholding the district court’s determinations, the Third Circuit extensively analyzed the relevant law to reach its decision. It began with a detailed discourse on federal arbitration law and the application of the New York Convention. The court pointed out that in spite of the strong federal policy favoring arbitration, to compel a party to arbitrate the court must determine that there is an agreement to arbitrate and that the dispute falls within the scope of that agreement. In answering these two questions, the court first addressed whether the presumption in favor of arbitration applies to one or both of these questions. The court, after a detailed analysis, concluded that the presumption in favor of arbitration probably does not apply to the question of whether there is an agreement to arbitrate.

The court next addressed the question of whether the standard to be applied in determining whether there is an agreement to arbitrate is that the agreement to arbitrate must be express or unequivocal. The court discussed the applicability of the express or unequivocal standard in the context of the existence of a triable issue of fact, which the court stated was not the case here. The court concluded that, under federal law, a purported

arbitration agreement cannot be subjected to satisfying requirements more demanding than that applied to other agreements. Accordingly, a substantive requirement that the arbitration agreement be “express” and “unequivocal” to be enforceable is forbidden by federal arbitration law.

Using ordinary Pennsylvania law contract principles, the court determined that the parties did, in fact, form an agreement to arbitrate by incorporating by reference the arbitration clauses from the underlying reinsurance treaties. The court found that the general incorporation clause in the retrocessional treaties effectively incorporated the arbitration agreement set forth in the underlying treaties. Moreover, a second paragraph of the retrocessional treaties following the general incorporation clause specifically applied all the terms and provisions of the underlying treaties to the retrocessional treaties. Although the court found some imprecision in the incorporation language, it concluded that the most reasonable and natural construction of the incorporation clause is to apply the clause to include the arbitration provisions of the underlying treaties.

The court then found that the dispute fell within the scope of the arbitration agreement incorporated by reference into the retrocessional treaties. The court held that

the arbitration clause was broad in scope and was subject to the presumption of arbitrability. Accordingly, the dispute about whether declaratory judgment expenses are covered fell within the scope of the arbitration agreement. The circuit court found that the district court properly compelled the retrocedent to arbitrate.

Finally, the court addressed whether the exclusion of extrinsic evidence of industry custom and practice and the retrocessionaire’s historical corporate practice by the arbitration panel was a ground to vacate the arbitration award. Because of the wide latitude given arbitrators in making evidentiary determinations and because the panel’s evidentiary rulings did not deprive the retrocedent of a fair hearing, the court held that there was no statutory basis to vacate the award.

Second Circuit Remands Question of Arbitrability and Waiver After \$34.3 Million Jury Verdict Against Cedent

AXA Versicherung AG v. New Hampshire Ins. Co., No. 08-2521-cv, 2009 U.S. App. LEXIS 21923 (2d Cir. Oct. 6, 2009) (summary order).

The Second Circuit Court of Appeals recently issued a summary order, which has no precedential effect, remanding a \$34.3 million jury verdict against a cedent, citing several issues concerning arbitra-

bility and waiver that needed to be resolved by the district court before the circuit court could consider the arguments on appeal. The reinsurer brought the underlying claim for fraudulent inducement concerning two reinsurance facilities. The reinsurer claimed that the cedent promised that the reinsurance facilities would be operated on a facultative obligatory basis, but secretly intended to, and did in fact, treat the facilities as purely facultative and not obligatory. A stay of arbitration was granted early on in the case. Following a trial, the jury returned a verdict finding for the reinsurer on the fraudulent inducement claim, and rescinded its participation in both facilities. Compensatory and punitive damages were awarded.

On appeal, the cedent argued that the reinsurer’s claims should have been arbitrated because they sounded in contract, and that the parties had previously agreed to arbitrate all contract claims. The reinsurer responded that its claims sounded in fraud, not contract, and that, in any event, the cedent had waived its right to arbitrate.

The Second Circuit found that the district court gave short shrift to the issues presented on appeal. “The District Court referred to the distinction between fraud and contract claims,” the Second Circuit noted, “but the Court did not explain why

[the reinsurer's] claims did not involve a breach of contract." As such, the Second Circuit concluded that a remand was appropriate "to allow the District Court, which is intimately familiar with the full scope of [the reinsurer's] evidence after presiding over the jury trial and issuing several rulings in this case, the opportunity to address in the first instance the extent to which [the reinsurer's] allegations sound in contract as opposed to fraud."

4 | The Second Circuit acknowledged that such a remand would be unnecessary if, as the reinsurer had argued, the cedent waived its right to arbitration, but found that the district court had failed to sufficiently address that issue as well. After suggesting three factors to consider in determining waiver — "(1) the time elapsed from commencement of litigation to the request for information, (2) the amount of litigation (including any substantive motions and discovery), and (3) proof of prejudice" — the Second Circuit noted that "[a] few factual clarifications in particular would facilitate consideration of the first and critical third waiver factors, the time elapsed and prejudice."

Thus, the Second Circuit remanded the case to the district court for further proceedings on both the arbitration and waiver issues and requested a quick return to the circuit court to resolve the issues on

appeal after the district court makes its findings.

Seventh Circuit Denies Petition for Rehearing After Upholding Arbitration Award Following Replacement of Arbitrator

Wellpoint, Inc. v. John Hancock Life Ins. Co., No. 08-2283, 2009 U.S. App. LEXIS 21265 (7th Cir. Sept. 22, 2009).

The Seventh Circuit Court of Appeals denied a petition for rehearing and rehearing en banc following the court's August 7, 2009 decision confirming an arbitration award and upholding the replacement of an arbitrator. Please see our September 2009 Reinsurance Newsletter at page 1 for a summary of the original Seventh Circuit's panel decision.

New York Federal Court Grants Motion to Compel Arbitration With Competing Agreements and Clauses

TPG Group v. Alternative Re Holdings, Ltd., No. 08 Civ. 11244 (SHS) (S.D.N.Y. Sept. 22, 2009).

In an action seeking rescission of a settlement agreement based on misrepresentation and fraudulent inducement, a New York federal court has stayed the litigation and granted the motion to compel arbitration under the broad arbitration clauses in a series of shareholder

agreements. The dispute arises out of shareholder purchase agreements of the assets of a reinsurer which provided capital for the reinsurer on a book of workers' compensation insurance. Ultimately, a settlement agreement and relevant amendments were entered into between the shareholders and the cedent in which all rights and liabilities were assigned to the shareholders. This dispute arose because of the additional requests for collateral arising because of deficits in the relevant accounts based on losses from the workers' compensation reinsurance program. The parties had started an arbitration proceeding under the various shareholder agreements, but the investors brought this action under the settlement agreement and against parties that were not all signatories to the shareholder agreements. The insurers/reinsurers moved to stay the litigation and compel arbitration.

In granting the stay of the litigation and the motion to compel arbitration, the court noted that the various shareholder agreements had broad arbitration clauses, but that the settlement agreement had a forum selection clause and not an arbitration clause. The court found that the Federal Arbitration Act applied because the dispute involved international commerce. The court read the various shareholder agreements, which all had

broad arbitration clauses, to be broad enough to encompass the dispute under the settlement agreement. The court refused to find that the forum selection clause in the settlement agreement, which made no mention of arbitration, superseded the parties' intent under all the other agreements to arbitrate disputes arising out of the investments concerning this workers' compensation program. The court held that the factual allegations involved agreements with broad arbitration clauses and therefore the claims against the settlement agreement were arbitrable.

This decision continues the trend in the federal courts to enforce arbitrability and to allow arbitration clauses, even in related agreements, to supersede forum selection clauses unless those forum selection clauses specifically exclude arbitration.

Wisconsin Federal Court Appoints Umpire and Rejects Disqualification Based on ARIAS-U.S. Certification

Employers Ins. Co. of Wausau v. Certain Underwriters at Lloyd's of London, No. 09-cv-201-bbc, 2009 U.S. Dist. LEXIS 89945 (W.D. Wis. Sept. 28, 2009).

A Wisconsin federal court has granted a cedent's motion to appoint an umpire and has denied the reinsurers' request to disqualify

the cedent's party-appointed arbitrator, in part, because of his ARIAS-U.S. certification.

This dispute arises out of whether specific risks were properly ceded under treaties covering commercial and residential property. The treaties contained broad arbitration clauses and a Wisconsin choice-of-law clause. The parties could not agree on an umpire and the cedent petitioned the federal court to appoint an umpire. In granting the petition, the court acknowledged jurisdiction under chapter 2 of the Federal Arbitration Act because of the applicability of the New York Convention.

The court reviewed the qualifications of six candidates and chose the candidate with the most experience in the industry and as an umpire, and also with the least connection to either party. The reinsurers objected to this candidate, as well as requesting disqualification of the cedent's party-appointed arbitrator, in part because these arbitrators were ARIAS-U.S. certified and the parent company of the cedent had an officer of ARIAS-U.S. The court firmly rejected this challenge as being "too attenuated to create action or apparent" partiality. The court pointed out that the certification criteria is objective and not subject to the approval of the cedent's parent. This may be the first time a party has challenged

ARIAS-U.S. certification as a factor in whether an arbitrator is biased.

In other issues addressed by the court, a motion by the reinsurers to dismiss the arbitration based on statute of limitations and other similar grounds was denied. The court held that affirmative defenses of timeliness, estoppel, and laches were issues for the arbitration. The court also rejected the application to disqualify the cedent's arbitrator, not only based on his ARIAS-U.S. certification discussed above, but also because he might have had ex parte communications. Noting that it is rare to disqualify an arbitrator for not being impartial, the court denied the application.

On October 23, 2009, the court denied a motion for reconsideration and clarification. *Employers Ins. Co. of Wausau*, No. 09-cv-201-bbc, 2009 U.S. Dist. LEXIS 98746 (W.D. Wisc. Oct. 23, 2009).

Illinois Federal Court Confirms Arbitration Award Including Attorneys' Fees

Certain Underwriters at Lloyd's, London v. Argonaut Ins. Co., No. 04 C 5852, 2009 U.S. Dist. LEXIS 87827 (N.D. Ill. Sept. 24, 2009).

An Illinois federal court has confirmed an arbitration award, which included an award of attorneys' fees. The cedent had defaulted on appointing its

arbitrator and the reinsurer had appointed the entire panel. The cedent's attempts to object to the panel failed. The arbitration panel found in favor of the reinsurers (denying recovery to the cedent) and the cedent sought to vacate the portion of the arbitration award that granted attorneys' fees to the reinsurer.

In upholding the award of attorneys' fees, the court noted that the cedent faced a stiff burden. The cedent argued that the fee award was in excess of the arbitrators' authority because it was inconsistent with a prior federal court ruling denying Rule 11 sanctions based on earlier motion practice and because the prior court order precluded an award of attorneys' fees based on *res judicata*. The court rejected both these arguments. The court held that nothing in the prior federal court order intended to prohibit any rulings by the arbitration panel and found nothing about the panel's award inconsistent with the prior court ruling. The court also found that no authority existed for the proposition that a denial of a motion for Rule 11 sanctions could be construed as a final judgment on the merits for claim preclusion purposes. As the cedent was only objecting the fee award, the court confirmed the arbitration award in favor of the reinsurer.

Pennsylvania Federal Court Vacates "Irrational" Arbitration Award

PMA Capital Ins. Co. v. Platinum Underwriters Bermuda, Ltd., No. 09-84, 2009 U.S. Dist. LEXIS 85046 (E.D. Pa. 2009).

A Pennsylvania federal court vacated an arbitration award finding that the award was irrational because the arbitrators' decision contravened the contract that was at the heart of the dispute and granted relief that was not sought by either party.

The initial dispute arose between the reinsurer and the cedent over a clause in the reinsurance contract that allowed the reinsurer to carry forward any deficit incurred under a previous contract. The cedent challenged the validity of the clause because the previous contract was between the cedent and a predecessor to the reinsurer. The cedent argued that the reinsurer had not been a party to the previous contract and therefore could not carry forward a deficit from losses incurred under it. Even if the clause were valid and enforceable, the cedent claimed that the reinsurer's calculations under the clause were inaccurate.

The parties agreed to submit the dispute to arbitration as required under the contract. The arbitrators were asked to decide whether

the clause was valid and if so how calculations under it should be made. Without a reasoned award explaining their decision, the arbitrators issued an award requiring the cedent to make an immediate one-time payment to the reinsurer and removing the disputed clause from the contract. The reinsured then filed this action seeking to vacate or modify the arbitration award.

In its decision to vacate the arbitration award, the court noted that its discretion in reviewing an arbitration award was "severely limited." The court stated that the arbitration award could only be vacated if it could not rationally be derived from the agreement of the parties or their submissions to the arbitrators and the terms of the award were completely irrational. The court vacated the award because the relief provided was not sought by either party, contravened the contract, and wrote a key provision of the contract out of existence. The court held that eliminating the disputed clause and ordering the payment by the cedent were not supported by the contract and therefore exceeded the arbitrators' discretion. The court noted that arbitration awards must draw their essence from the parties' agreement and the arbitrators may not re-write the terms of the contract. The court found that the contract required enforcement of the

disputed clause, not its elimination. In addition, the payment ordered conflicted with the terms of the clause, which required a payment from the cedent only after certain preconditions, including payout of the policy limits, had been met. The court also noted that neither party had asked the arbitrators to eliminate the disputed clause from the contract. Thus, the court found that the award was not rationally derived from the parties' agreement or their submissions to the arbitrators. The court held that the arbitrators had exceeded their power by ruling on questions not presented to them and providing relief that was not rationally related to the contract from which the dispute arose.

New York State Appeals Court Denies Motion to Enjoin Arbitration

Life Receivables Trust v. Goshawk Syndicate 102, No. 601244/08, 2009 N.Y. App. Div. LEXIS 7188 (N.Y. App. Div. 1st Dep't Oct. 13, 2009).

A New York intermediate appellate court has denied a cedent's motion to stay or enjoin arbitration. The arbitration agreement required all disputes to be arbitrated under the American Arbitration Association ("AAA") rules. The AAA rules authorize the arbitrators to rule on its own jurisdiction, including the scope and validity of the arbitration agreement. Where the rules so provide,

the courts will leave the question of arbitrability to the arbitrators.

The dispute here, however, was over the provision in the arbitration agreement that gave the parties the right to challenge the arbitration award on the ground that the arbitration panel made an error of law. A provision like this was struck down by the United States Supreme Court in *Hall St. Assoc. L.L.C. v. Mattell, Inc.*, 128 S. Ct. 1396 (2008). Although a concurring opinion discussed this issue in great detail, the majority held that it did not need to reach the issue of whether that portion of the arbitration agreement was severable, because that issue was among the arbitrability issues to be decided by the arbitrators. Thus, the court allowed the arbitration to go forward even with the error of law challenge language in the arbitration agreement.

Third Circuit Vacates Summary Judgment Against Reinsurer That Ignored Liability Cap in Contract Ambiguity Case

Princeton Ins. Co. v. Converium Reinsurance, No. 08-2136, 2009 U.S. App. LEXIS 20401 (3rd Cir. Sept. 14, 2009).

The Third Circuit Court of Appeals has vacated an order of summary judgment granted by a New Jersey federal court in favor of a cedent,

finding that the reinsurance contract was ambiguous on its face.

The parties contracted to reinsure the cedent's workers' compensation policies on an excess-of-loss basis. The reinsurance contract was drafted by the cedent's agent, and it contained a provision that pay-outs were "subject to" a warranty that capped employers' liability ("EL"). The contract did not initially cover New York policies, but it was later expanded to do so.

The cedent issued a workers' compensation policy with an EL limit that was unenforceable under New York law, although the cedent was not aware of that fact when the policy was issued. The pivotal issue for the circuit court was whether the warranty provision's cap limited the reinsurer's liability. The court's analysis focused on a provision that the reinsurer had insisted on adding to the warranty: that the cedent warrants that the EL cap was as followed in the contract, *or so deemed*. The court concluded that the trial court had ignored this emphasized language in error, but also found that the language properly could be read in either of two ways, the difference being whether a cap would be inferred for policies that included caps that could not be enforced under the applicable state law.

Due to the reasonableness of two different interpretations of the provision, the circuit court found that the contract was ambiguous, and that summary judgment should not have been granted in favor of either party. The order of summary judgment granted by the trial court was vacated, and the case was remanded for further proceedings.

New York Federal Court Denies Request to Amend Complaint for Statutory Bad Faith Claim Against Reinsurer

Callon Petroleum Co. v. Nat'l Indemn. Co., 2:06-CV-0573 (JS) (MLO), 2009 U.S. Dist. LEXIS 75514 (E.D.N.Y. Aug. 24, 2009).

A New York federal court denied a policyholder's request to amend its complaint against a reinsurer to assert a claim of bad faith for failing to timely pay a claim on a surety bond. The policyholder obtained a judgment in Louisiana federal court against the cedent and sought to enforce that judgment against the reinsurer. In denying the claim, the court found that New York law applied and that under New York law the amended claim would not survive a motion to dismiss. Accordingly, it would be futile to grant the motion to amend the complaint.

The policyholder sought to amend its complaint to assert a claim

of bad faith under Louisiana law. The court found that there was no evidence presented that Louisiana law had any applicability to the reinsurance agreement. Under a choice-of-law analysis, the court found that New York law, not Louisiana law applied to the reinsurance agreement. Accordingly, the motion was denied because the amendment would be futile.

Illinois Federal Court Grants Purported Reinsurer's Motion to Dismiss Claim

Guarantee Trust Life Ins. Co. v. First Student Programs, LLC, No. 05 C 1261, 2009 U.S. Dist. LEXIS 81136 (N.D. Ill. Sept. 8, 2009).

In a dispute about whether a program administrator had obtained reinsurance for a student health insurance program, an Illinois federal court has dismissed the claims against the purported reinsurer based on the determinations of an underlying arbitration proceeding between the cedent and the purported reinsurer. The program administrator allegedly engaged the purported reinsurer to reinsure the cedent. In an arbitration brought by the cedent against the purported reinsurer, the arbitrator determined that no agreement had been made. The arbitration award was confirmed by an Illinois federal court.

The cedent brought a breach of contract action against the program administrator for its failure to obtain reinsurance and the program administrator brought a third-party action against the purported reinsurer. In granting the purported reinsurer's motion to dismiss, the court applied Illinois law, the substantive law of the state where the court confirming the arbitration award sat. Because there was a final judgment on the merits, an identity of the causes of action, and because the administrator was in privity with the cedent, the court held that the claims against the purported reinsurer should be dismissed.

Illinois Federal Court Dismisses Claim Brought By Pool Administrator Acting Solely as Attorney-in-Fact

Nat'l Council on Compensation Ins., Inc. v. Am. Int'l Group, Inc., No. 07 C 2898, 2009 U.S. Dist. LEXIS 73871 (N.D. Ill. Aug. 20, 2009).

An Illinois federal court has held that a trade association acting as attorney-in-fact has no standing to bring a claim on behalf of a residual market reinsurance pool for workers' compensation and has dismissed the complaint. This case involves the manner in which many states provide for residual workers' compensation insurance. The pool is administered by a national statistical and rate-making organization.

The reinsurance participation rate calculated by the administrator for each workers' compensation insurer that is a member of the pool is based upon the workers' compensation premiums each company wrote in the voluntary market. Underreporting of premiums would naturally decrease the reinsurance participate rate.

After it was revealed that one of the pool members underreported its premiums for years, the administrator brought suit on behalf of the remaining member companies for damages resulting from the underreporting. The pool, however, was not named as a plaintiff and the individual pool members were not parties to the case. The defendant moved to dismiss the case for lack of standing by the pool administrator.

In granting the motion, the court found that the pool administrator lacked standing to bring the claim. Citing United States Supreme Court precedent, the court held that merely assigning a case to an attorney to prosecute does not confer standing on the attorney. Although the pool participation agreement gave the administrator the right to prosecute claims, it did not transfer legal title of the claim to the administrator. Thus, the suit was brought solely in the capacity as an attorney-in-fact. In analyzing the various bases for standing, the

court found none to exist, including association standing because of the inherent conflict among the pool members. Accordingly, the court dismissed the complaint.

Texas Federal Court Refuses to Enjoin State Court Claims Arising Under Previously Litigated Reinsurance Treaties

Aon Re, Inc. v. TIG Ins. Co., No. 3:09-cv-0300-B, 2009 U.S. Dist. LEXIS 89249 (N.D. Tex. Sept. 28, 2009).

A federal court in Texas denied a reinsurer's motion for a preliminary injunction against the cedent based on a finding that the reinsurer failed to demonstrate a likelihood of success on the merits in showing that application of the relitigation exception to the Anti-Injunction Act applied.

The reinsurer moved to enjoin the cedent from bringing claims against it in California state court arising out reinsurance treaties entered into between the parties in 1998 and 1999, which had been previously litigated in Texas federal court and resolved in favor of the reinsurer on statute of limitations grounds. Nevertheless, the cedent brought claims against the reinsurer, based at least in part on issues relating to the two treaties, in California state court. The reinsurer sought an injunction from the Texas federal

court to preclude the cedent from pursuing future claims arising out of the two treaties in the California state court case, as it contended those issues had all been previously resolved in a prior litigation. In response, the cedent claimed that the Anti-Injunction Act applied, which generally prohibits a federal court's injunction preventing a state court from exercising its jurisdiction. The reinsurer contended that the "relitigation" exception to the Anti-Injunction Act applied, but the court held that reinsurer failed to demonstrate, under the standards required to obtain a preliminary injunction, that the prior judgment based on statute of limitations grounds was a judgment "on the merits," which would have entitled the reinsurer to the preclusive effect of the relitigation exception to the Anti-Injunction Act.

New York Intermediate Appellate Court Upholds Principal/Agent Relationship, But Reverses Summary Judgment Dismissing the Cedent's Counterclaim of Reformation

Gulf Ins. Co. v. Transatlantic Reinsurance Co., 886 N.Y.S.2d 133 (App. Div. 1st Dep't, 2009).

A New York intermediate appellate court has ruled that a principal/agency relationship exists even where contract language attempts to define the agent as an indepen-

dent contractor, but reversed rulings on summary judgment based on triable issues of fact. The dispute centered on a series of quota share treaties on automobile residual value business. The reinsurer refused to pay its alleged share of a large settlement because the cedent failed to disclose that, at the time the parties entered into the reinsurance agreement, the cedent had been seeking a 360 percent increase in the premium rate on its largest policy.

The cedent argued that the “material facts” that it allegedly failed to disclose were not known at the time by the cedent, but only by the cedent’s managing general agent. The cedent argued that the managing general agent with knowledge of the material facts was not actually its agent, but rather an independent contractor, citing a single recitation in the agreement that “the General Agent is not an employee of the Company for any purpose, but is an independent contractor for all purposes and in all situations.” The court rejected this argument, stating that “[r]egardless of whether this recitation might be effective to disclaim an employment relationship, it is not effective as a disclaimer of an agency relationship.” The appellate court affirmed the trial court’s decision not to grant summary judgment on the reinsurer’s rescission claim because the

materiality of the information not disclosed was for the jury to assess.

A second issue involved interpretation of a treaty provision regarding the risks to be covered under the quota share reinsurance agreements when compared to the percentage of participation on the interest and liabilities agreement that the reinsurer signed. The issue was whether the signed line on the interest and liabilities agreement was a percentage of 100 percent of the cedent’s business or a percentage of the overall quota share participation (e.g., 6.5 percent of 45 percent or 6.5 percent of 100 percent). The appellate court affirmed the trial court’s finding that the reinsurer had a 6.5 percent participation in the 45 percent quota share and that the quota share was not equal to 100 percent of the cedent’s net retained liability. Yet, the appellate court reversed the grant of summary judgment dismissing the cedent’s reformation counterclaim on this issue based on course-of-performance and other extrinsic evidence demonstrating mutual mistake.

A third issue concerned whether the reinsurer was responsible for certain business under the 1999 treaty that resulted from a 1998 policy. The issue concerned a construction of the term “attaching.” This was a losses occurring during on policies attaching during the term

contract. The trial court had granted summary judgment holding that the 1999 extension of the 1998 policy was not covered by the 1999 treaty. The appellate court held that summary judgment should have been denied because neither party presented evidence bearing on when the agreement was reached on the extension and when it was intended to be effective. Yet on another issue concerning exposure to the 1998 treaty, the appellate court affirmed the grant of summary judgment in favor of the reinsurer because the cedent was unable to prove any valid agreement that the reinsurer would cover business that was ceded to the 1998 treaty.

Massachusetts Court Grants Summary Judgment to Policyholder on Redomestication Claim

The Gen. Electric Co. v. Lines, 26 Mass. L. Rep. 66 (Mass. Super. Ct. Aug. 3, 2009).

In the latest decision in the long-running EMLICO saga, a Massachusetts court has dismissed a succeeding reinsurer’s counterclaim against the policyholder that its decision to redomesticate the captive cedent was a breach of its fiduciary duty to the cedent and the reinsurers. The reinsurer’s successor claimed that it had no obligation to the cedent for environmental claims because of the policyholder’s alleged breach of

fiduciary duty in orchestrating the redomestication to bolster its coverage claim. In granting the policyholder summary judgment on this claim, the court concluded that even if the reinsurer's successor could establish the facts alleged about the redomestication, it had no reasonable expectation of demonstrating a breach of fiduciary duty by the policyholder that would relieve the reinsurer's successor from its reinsurance obligations to the cedent. This holding was bolstered by previous holdings by other courts that the redomestication did not harm the cedent or disadvantage the reinsurers.

Recent English Case Summaries

Unraveling the LMX Spiral

Equitas Limited v. R&Q Reinsurance Co.(UK) Ltd [2009] EWHC 2787 (Comm).

The question in this case was whether Equitas was able to recover losses under various retrocession excess-of-loss reinsurance contracts written by R&Q within the London Market Excess of Loss (LMX) spiral. Equitas argued its losses were capable of being proved through actuarial modeling. The R&Q case was that this “*guess-work*” entitled Equitas to recover nothing because it failed to prove its losses. In what has been called a test case, the court found in favor of

Equitas, which leaves the rest of the LMX market to work out whether cedents can use similar modeling techniques to re-present their own claims.

The LMX spiral involved syndicates writing excess-of-loss (XL) cover. They frequently took out their own XL cover with reinsurers who in turn did the same thing. A small group of reinsurers was responsible for a complex network of mutual insurance described as the spiral. When claims were made by primary insurers on their XL cover, the liabilities were passed on (and magnified) in a multiple game of pass the parcel.

Two events, the 1989 running aground of the Exxon Valdez, and the loss of fifteen aircraft owned by Kuwait Airways (KA) and one aircraft owned by BA when Iraq invaded Kuwait in 1990, resulted in catastrophic losses. Losses flowing from both events were passed from XL reinsurer to XL reinsurer within the LMX spiral.

The aircraft losses were initially paid on the basis they arose out of one event (the invasion of Kuwait). Later, it was questioned whether it was correct to aggregate the losses of the BA and KA aircraft and claims stopped being paid. Some years later, in 2003, the Court of Appeal decided the issue (*Scott v. Copenhagen Re Co (UK) Ltd* [2003] LR IR

696), holding that the KA and BA losses should not have been aggregated as they did not arise out of the same event.

In the case of the Exxon Valdez, substantial claims against insurers were made for an indemnity for clean-up costs. The scope of the cover provided to Exxon was challenged, claims stopped being paid, and litigation followed. Two decisions (*Commercial Union v. NRG* [1998] 2 LR 600 and *King v. Brandywine Reinsurance Co* [2005] EWCA 235) made certain elements of the Exxon Valdez loss irrecoverable, meaning that they ought not to have been included in claims that had entered the LMX spiral.

By the time the market stops paying, it is estimated that payments of \$6 billion will have been made by the market on each of the two losses.

Equitas (as assignee of the rights of various Lloyd's syndicates) argued that the contracts should be enforced using the best evidence available to quantify the amount of recoverable loss. Recoverable losses were capable of being proved, and it had proved them on the balance of probabilities, using actuarial modeling. This allowed appropriate discounts to strip out the wrongly aggregated or irrecoverable elements, leaving a minimum

recoverable amount properly due under each reinsurance contract.

R&Q argued that Equitas had to replicate the LMX spiral at each level without the wrongly aggregated KA/BA settlements and irrecoverable Exxon settlements. In other words, Equitas needed to prove that the sums claimed were properly due, contract by contract. Estimation and guesswork would not do. In R&Q's view, the losses of individual syndicates could not be proved by a generalized model that did not replicate the LMX spiral. This meant that Equitas was entitled to recover nothing at all. Even if it could overcome the hurdle of using an actuarial model, the model it was using was flawed and did not achieve its purpose. R&Q's case was all or nothing; it did not suggest any rival model.

First, Equitas needed to satisfy the first rule of Lord Mustill in *Hill v. Mercantile* [1996] 1 WLR 1239 (HL), that a reinsurer could not be held liable unless the loss fell within the cover of the underlying policy and within the cover created by the reinsurance. R&Q argued that this rule could only be satisfied if Equitas re-presented correctly aggregated losses upwards through the spiral.

Gross J concluded that Equitas must satisfy Lord Mustill's first rule or fail, but it was not a requirement of law that Equitas could only do so

by proving a loss at each underlying level of the LMX spiral. How Equitas attempted to satisfy the first rule was a question of fact or evidence.

Second, Equitas sought to use actuarial modeling to make good its case. There was, it said, no reason of principle why a suitable model could not be used to do this. While it was common ground that the models did not try to recreate the actual spiral, they provided reasonable representations of the relevant features which mattered. There could be confidence that the attachment points for the individual syndicates had been reached. R&Q disagreed, arguing that the models did not discharge Equitas' burden of proof because they did not prove that the individual attachment points had been reached.

Gross J concluded that Equitas was free to use such evidence as it chose to satisfy its burden of proof. There was no logical objection in principle to the use of models. If Equitas was facing the choice of either abandoning its claims (because the spiral could not be reconstructed) or trying to claim using the model, he could see no reason why they should be stopped from making the attempt.

Third, the question was functional: were the models capable of and did they succeed in establishing Equitas' claims? In other words,

did the models enable conclusions to be drawn, on the balance of probabilities, about the recoverable losses of each syndicate. This was described as moving from the "general to the particular."

Gross J was satisfied that the models' output enabled conclusions to be drawn with confidence about recoverable losses for each syndicate for reasons including:

- There was a relationship between the model spiral and reality.
- There was an expectation that the results of the model players would represent actual players without extreme characteristics.
- The syndicates did not have such extreme characteristics.
- Through the models Equitas had demonstrated the attachment points for the individual syndicates had been reached.
- Across-the-board discounts generated by the models were conservative and showed, on the balance of probabilities, the minimum allowable losses of the syndicates.

The decision may enable other cedents to re-present claims to reinsurers without trying to reconstruct the spiral. Where historically the spiral has been in "lockdown," this could lead to its unraveling. The decision, however, is particular to spiral losses and does not have a wider application in the context of

presenting losses to reinsurers more generally.

Did English Law Apply to a Reinsurance Contract?

Gard Marine & Energy Ltd v. Lloyd Tunncliffe [2009] EWHC 2388 (Comm).

In this case the English Commercial Court found that the Bermudian claimant had an arguable case that: (1) its reinsurance contract with Swiss reinsurer, Glacier Re, was governed by English law despite there being no express choice of law; and (2) the English court had jurisdiction under article 6(1) of the Lugano Convention because the claims were so closely connected that the risk of inconsistent findings needed to be avoided.

The original policy insured Devon Energy Corporation (DEC) for, among other things, property and business interruption risks between 1 July 2003 - 1 September 2005. The period was extended to 1 September 2007 by endorsement dated 4 August 2005 with a combined single limit of \$400 million. The claimant insured 12.5 percent of this risk (\$50 million). Its broker arranged reinsurance of its whole 12.5 percent line through two excess-of-loss reinsurance slips with a deductible of \$250 million. London market underwriters subscribed to one slip for 7.5

percent of the whole and Glacier Re signed the other for 5 percent of the whole.

In September 2005, Hurricane Rita caused damage to DEC's interests in the Gulf of Mexico. Its claim under the original policy, up to policy limits, was settled for \$365 million of which the claimant paid 12.5 percent. The claimant claimed against its reinsurers calculating that the \$250 million deductible was referable to 100 percent property values. Therefore, when a claim was made for property where DEC had less than a 100 percent interest, the deductible should be "scaled" to reflect that.

All reinsurers initially disputed scaling of the deductible, although by April 2008 only Glacier Re and Advent were fighting on. Glacier Re paid the amount that it said it was due under its slip, *i.e.*, \$5.75 million calculated on an excess attachment point of \$250 million. It refused to pay the balance and even argued that it was not liable for any part of the claim and should be able to recover what it had paid.

English proceedings were started in March 2007, but were stayed because Glacier Re had already started proceedings in Switzerland seeking repayment of sums paid to the claimant. In June 2009, the Swiss proceedings were dismissed on appeal. The Swiss court had no

jurisdiction because the claimant was not domiciled in Switzerland. As a result, the stay of the English proceedings was lifted and Glacier Re's objections to the English court's jurisdiction needed to be addressed.

The question for the court was whether Glacier Re's reinsurance contract was governed by Swiss law (as Glacier Re argued) or English law (as the claimant argued). The starting point was article 3 of the Rome Convention (incorporated by the Contracts (Applicable Law) Act 1990). This provides that "[a] contract shall be governed by the law chosen by the parties. The choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case." The London market slip was subject to an express choice of English law and jurisdiction. There was no express choice of law in the Glacier Re slip.

The court found that the claimant had established at least a good arguable case that English law was the applicable law because (1) London based brokers placed the business; (2) a Lloyd's slip and policy were used; (3) the slip incorporated a number of London market wordings; and (4) the wording included provisions that had particular relevance to English law.

Another question for the court was whether the claimant was able to establish the English court's jurisdiction under article 5(1) and/or 6(1) of the Lugano Convention (the applicable jurisdiction regime between the UK and Switzerland). Article 5 (1) of the Lugano Convention provides that "A person domiciled in a Contracting State may, in another Contracting State, be sued: 1. in matters relating to a contract, in the courts for the place of performance of the obligation in question ..."

Under English law the place of performance is where the creditor resides. As the claimant resided in Bermuda, Glacier Re argued that article 5(1) was inapplicable. The court held that the claimant did not have a good arguable case that the

English court had jurisdiction under article 5(1). It had not established an obligation to pay claims to the brokers in London and a practice of doing so was insufficient.

Under Article 6(1) of the Lugano Convention, "A person domiciled in a Contracting State may also be sued: 1. where he is one of a number of defendants, in the courts for the place where any one of them is domiciled." The issue here was whether the claims were so closely connected that they should be heard together to avoid the risk of irreconcilable judgments in separate proceedings. The court found that the claimant had at least a good arguable case that the court had jurisdiction under article 6(1) because the claimant's claims turned on the proper construction

of the sum insured clause, which was the same in both reinsurance contracts and part of a common reinsurance programme; there was no material difference between the terms of the two contracts making the legal issues in both the same; the claimant's claims were connected by the contingent claim against the broker, which was likely to involve common issues of fact; in all of the claims there was a real risk of different outcomes and inconsistent findings; and it was "... overwhelmingly just, convenient and expedient" that all of the claims be determined in one jurisdiction. The English Commercial Court, therefore, had jurisdiction over the claim against Glacier Re and rejected its jurisdictional challenge.

"Best Law Firm" Awarded to Dewey & LeBoeuf at *Reactions* Global Awards 2009

Dewey & LeBoeuf was honored with the "Best Law Firm" award at the 2009 *Reactions* Global Awards, which recognizes achievement in the insurance and reinsurance industry. The distinction marks the eighth consecutive year the firm has received this award.

Reactions announced its annual awards to the world's best insurers, reinsurers, brokers and service providers at its Global Awards Dinner in New York on September 24. Jane Boisseau, co-chair of the firm's Insurance Regulatory Department, accepted the award on behalf of the firm.

This marks the eighth year that *Reactions* has conducted its Global Awards program and the fourth year that it has held its Global Awards

Dinner. The awards are the result of an extensive poll conducted by *Reactions* of its readership, which includes executives at insurance and reinsurance companies, brokers, risk managers and service providers.

Reactions is a financial publication that provides business intelligence to the global re/insurance market.

Recent Speeches and Publications:

John Nonna will be speaking on mediation at HB Litigation's Mediating Complex Disputes From Toxic Torts to Reinsurance, January 27, 2010, New York City.

Hugh McCormick will be speaking on "Utilizing Innovative Capital Management Techniques to Reduce Insurance Risk" at the American Conference Institute's 4th Annual Legal and Strategic Forum on Life Reinsurance on January 29, 2010, in New York City.

John Nonna is moderating a panel on "Strategic Planning for Lawyers," and Larry Schiffer is speaking on a panel on updating and fixing reinsurance arbitration, at the HB Litigation's 17th Annual Insurance Insolvency & Reinsurance Roundtable, on March 24-26, 2010, in Scottsdale, Arizona. The firm is also sponsoring the March 25th Networking Reception at the Roundtable.

Larry Schiffer is speaking on a panel on "Conflict Resolution: Strategies for Resolving Disputes Quickly and Cost-Effectively," at the American Conference Institute's 8th International Advanced Forum on Run-Off and Commutations, on April 30, 2010, in New York City.

John Cleary spoke on "Reinsurance Considerations in Finance," at the HB Litigation Reinsurance Claims & Dispute Resolution Conference on September 10, 2009, in Washington, DC.

Bill Marcoux spoke on "Evolution of the Brazilian Reinsurance Market: Tracing the Path of the Market From Its Opening to Present," at the American Conference Institute's Second International Forum on Brazilian Reinsurance, September 16-17, 2009, New York City.

Francis Mackie and Larry Schiffer co-chaired and spoke at Falconbury's Reinsurance Contract Wordings and Disputes conference on October 8-9, 2009, in Hamilton, Bermuda. Francis spoke on "Contract Certainty" and Larry spoke on "Follow the Settlements/

Follow-the-Fortunes Clauses." Both acted as opposing counsel in a mock reinsurance dispute involving a fact pattern similar to the *Lexington v. WASA* case recently decided by the House of Lords.

Larry Schiffer moderated a panel on "Credibility Matters: False Testimony and Other Misbehavior in Reinsurance Arbitrations" at the 2009 Fall Meeting of ARIAS-U.S. on November 12, 2009, in New York City.

Larry Schiffer's article, "Third-Party Guarantees of Reinsurance Obligations: I Guarantee It!," was re-published in the September 2009 *Insurance Chronicle* (the Icfai University Press, India).

Larry Schiffer's Commentary, "Playing the Name Game — An Update on Cut-Through Clauses" was published on IRMI.com, the Web site of International Risk Management Inc., on August 28, 2009, and was re-published in the November 2009 edition of the *Insurance Chronicle* (the Icfai University Press), India.

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New York

1301 Avenue of the Americas	+1 212 259 8117	Lawrence W. Pollack	lpollack@dl.com
New York, NY 10019-6092	+1 212 259 8311	John M. Nonna	jnonna@dl.com
Facsimile: +1 212 259 6333	+1 212 259 8086	Larry P. Schiffer	larry.schiffer@dl.com
	+1 212 259 8239	Eridania Perez	eperez@dl.com

Los Angeles

333 South Grand Avenue, Suite 2600	+1 213 621 6031	Dean Hansell	dhansell@dl.com
Los Angeles, CA 90071-1530			
Facsimile: +1 213 621 6100			

Washington, DC

1101 New York Avenue, N.W., Suite 1100	+1 202 346 8036	Elizabeth B. Sandza	ebsandza@dl.com
Washington, DC 20005-4213			
Facsimile: +1 202 986 8102			

London

1 Minster Court	+44 20 7459 5007	Peter J. Sharp*	pzsharp@dl.com
Mincing Lane	+44 20 7459 5031	Nicholas D. Rochez*	nrochez@dl.com
London, EC3R 7YL	+44 20 7459 5013	Francis O. Mackie*	francis.mackie@dl.com
Facsimile: +44 20 7459 5099	+44 20 7459 5006	David J. Waldron*	dwaldron@dl.com
	+44 20 7459 5008	Nicholas E. Greenwood*	ngreenwo@dl.com
	+44 20 7459 5070	Damian Cleary*	damian.cleary@dl.com

Paris

51 rue Pierre Charron	+32 1 53 93 77 00	Jean Alisse	jalisse@dl.com
75008 Paris			
Facsimile: +33 1 42 56 08 06			

* Partner in the London-based multinational partnership

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