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EXPERT ANALYSIS

# New York High Court Accepts 2nd Circuit's Certified Question on Important Reinsurance Limits Issue

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For decades, reinsurers have relied on the 2nd Circuit's 1990 decision in *Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co.*[1] regarding the applicability of reinsurance limits to obtain windfalls that the contracting parties never contemplated when the contracts were formed.

Over the past several years, however, courts have begun to chip away at the ability of reinsurers to rely on the *Bellefonte* decision in this way.[2]

A recent ruling from the 2nd Circuit directly questions the continued validity *Bellefonte* and its progeny.[3]

In the recently decided case, Global Reinsurance Corp. of America reinsured insurance policies Century Indemnity Co. had issued to Caterpillar Tractor Co.

The policies that Century issued to Caterpillar had limits applicable to loss payments, which are payments made for settlements or judgments resulting from claims made against Caterpillar.

The policies also obligated Century to pay expenses. Expenses are amounts paid in connection with defending claims against Caterpillar, including attorney fees. The policies required Century to pay those expenses in addition to the policy limits applicable to loss.

After Century made expense payments in addition to the insurance policies' limits, it sought reimbursement from Global for Global's share of those payments.

Global refused to pay, contending that the "reinsurance accepted" amount in the Global reinsurance contracts was an absolute cap on Global's liability for loss and expense. The U.S. District Court for the Southern District of New York agreed with Global, relying "primarily" on the *Bellefonte* decision.

On appeal, Century and "four large reinsurance brokers" contended that *Bellefonte* was wrongly decided.

The 2nd Circuit found that contention was "not without force" and doubted the continuing validity of *Bellefonte*. The court stated that it was "difficult to understand the *Bellefonte* court's conclusion that the reinsurance certificate in that case unambiguously capped the reinsurer's liability for both loss and expenses."

Looking back at the language of the certificate at issue in *Bellefonte*, the 2nd Circuit found that "it is not entirely clear what exactly the 'reinsurance accepted' provision in *Bellefonte* meant."

Despite its inability to understand the conclusion in *Bellefonte*, the court refrained from expressly overruling the decision and instead decided to certify a question to the New York Court of Appeals.

The court sought the New York high court's guidance "as to whether a consistent rule of construction specifically applicable to reinsurance contracts exists." It said the issue is "a question of New York law that the New York Court of Appeals has a greater interest and greater expertise in deciding than" the 2nd Circuit does.

In particular, the certified question concerns the interpretation of the New York Court of Appeals' decision in *Excess Insurance Co. v. Factory Mutual Insurance Co.*[4] However, before framing the certified question, the 2nd Circuit specifically found that *Excess* was not controlling for two reasons.

First, in *Excess*, "the parties agreed that the reinsurance policy contained a liability cap." The case before the 2nd Circuit involved the "antecedent question of whether the stated limit represented an absolute coverage limit for losses and expenses combined."

Second, *Excess* involved the issue of whether the reinsurer had to cover costs the insurer had spent litigating with its policyholder, also known as declaratory judgment expenses. The 2nd Circuit's *Global v. Century* case involved coverage for expenses the insurer had incurred in defending its policyholder against claims against the policyholder.[5]

Nevertheless, the 2nd Circuit asked the New York Court of Appeals to clarify whether *Excess* imposed "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."

Some courts have found that *Excess* stands for a presumption that reinsurance contracts contain an absolute cap on the reinsurer's obligation to pay loss and expenses,[6] even though New York law has for decades required courts to interpret each contract according to its unique terms.[7]

Indeed, the 2nd Circuit had previously found that *Excess* did not require the application of any such presumption.[8] Nonetheless, the 2nd Circuit asked the New York Court of Appeals to clarify whether *Excess* contains that presumption.

The New York high court accepted the certified question, and its decision may provide further guidance to courts on how to resolve the long-running dispute between cedents and reinsurers regarding how reinsurance limits apply.

A ruling consistent with long-standing New York law that there is no presumption to interpreting reinsurance contracts will further weaken reinsurers' arguments that reinsurance-accepted amounts are an absolute cap on their liability.

In addition, a ruling establishing a presumption that reinsurance contracts contain an absolute cap — despite the absence of any language in the reinsured policies supporting such a presumption — will likely be met with industry outcry and criticism, just as the *Bellefonte* decision was met with years ago.[9]

Regardless, the 2nd Circuit's ruling in *Global v. Century* in the meantime will join the growing line of rulings casting doubt on the ability of reinsurers to avoid paying expenses in addition to loss by relying on *Bellefonte* and its progeny.

## NOTES

[1] 903 F.3d 910 (2d Cir. 1990).

[2] Walter Andrews, Syed Ahmad & Patrick McDermott, *Bellefonte: The Tide Continues to Turn,* WESTLAW J. INS. COVERAGE, Apr. 22, 2016.

[3] Global Reinsurance Corp. of Am. v. Century Indem. Co., 843 F.3d 120 (2d Cir. 2016).

[4] 822 N.E.2d 768 (N.Y. 2004).

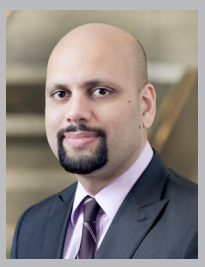
[5] The court also noted that the relevant provision in *Excess* used the word "limit" rather than the term "reinsurance accepted."

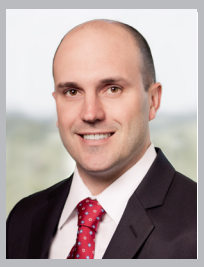
[6] *See Utica Mut. Ins. Co. v. Munich Reinsurance Am., Inc.*, 976 F. Supp. 2d 254, 264 (N.D.N.Y. 2013) ("The court therefore presumes that the certificate's limit-of-liability provision is unambiguously cost-inclusive."), *rev'd,* 594 F. App'x 700 (2d Cir. 2014).

[7] *See, e.g., Nautilus Ins. Co. v. Matthew David Events Ltd.,* 893 N.Y.S.2d 529, 531 (N.Y. App. Div., 1st Dep't 2010) (courts determine "the rights or obligations of parties under insurance contracts based on the specific language of the policies").

[8] *Utica Mut.*, 594 F. App'x at 704.

[9] *See* Eugene Wollan, *Sing a Song of Reinsurance,* ARIAS-U.S. QUARTERLY, First Quarter Review 1999, at 1 ("Many members of the reinsurance community were shocked by Bellefonte and Unigard, not because they were inherently horrifying decisions, but because they ran in the face of long-standing industry practice."); Michael H. Goldstein, *For Whom Does Bellefonte Toll? It Tolls for Thee,* 9 MEALEY'S LITIG. REP.: REINS. 12, Aug. 13, 1998 (recognizing that commentators criticized Bellefonte as "utterly at odds with decades-old custom and practice" and that Bellefonte was "roundly criticized in the reinsurance industry"); Michael H. Goldstein, *Bellefonte Lives,* 8 MEALEY'S LITIG. REP.: REINS. 9, Sept. 24, 1997 (stating that Bellefonte "was met by almost universal condemnation and in some quarters ridiculed by insurance and reinsurance claims people").





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