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Reinsurance Redux

The redux on developments in the law of reinsurance

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District Court Compels Arbitration of Claims Against Reinsurer

The United States District Court for the District of Arizona issued an order compelling arbitration of a dispute over the validity of a commutation agreement and holding that the dispute arose under a quota share reinsurance agreement containing an arbitration provision and that the reinsurer had not agreed to litigate or otherwise waived its right to arbitrate. *Repwest Insurance Co. v. Praetorian Insurance Co.*, – F. Supp. 2d –, No. CV 12-0369-PHX-JAT, 2012 WL 3704692 (D. Ariz. Aug. 28, 2012).

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Second Circuit Finds Error by District Court But Affirms Decision to Confirm Arbitration Award Where Parties Agreed to Submit Arbitrability Questions to Arbitrator

The United States Court of Appeals for the Second Circuit held that the United States District Court for the Southern District of New York improperly refused to determine whether a dispute was arbitrable but nonetheless affirmed the district court's decision to confirm an arbitration award because the parties had clearly and unmistakably agreed to submit questions of arbitrability to the arbitrator. *Schneider v. Kingdom of Thailand*, 688 F.3d 68 (2d Cir. 2012).

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District of New Jersey Grants Summary Judgment on Late Notice Defense and Calculation of Retention Under Retrocessional Agreements

The United States District Court for the District of New Jersey granted a reinsurer's motion for summary judgment with respect to the untimely notice defense raised by its retrocessionaire and with respect to the calculation of its retention under retrocessional agreements, but held that there were genuine issues of disputed fact with respect to the retrocessionaire's rescission counterclaim and whether certain claims were covered under the agreements. *Munich Reinsurance America, Inc. v. American National Insurance Co.*, – F. Supp. 2d –, Civ. A. No. 09-6435(FLW), 2012 WL 4475589 (D.N.J. Sept. 28, 2012).

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District Court Compels Arbitration of Claims Against Reinsurer

On August 28, 2012, the United States District Court for the District of Arizona held that a dispute over the validity of a commutation agreement was subject to the arbitration provision in a quota share reinsurance agreement. Repwest Insurance Company ("Repwest") entered into a quota share agreement with various companies, including Praetorian Insurance Company ("Praetorian") and Conestoga Casualty Insurance Company ("Conestoga"), in 1991 to reinsure a percentage of its losses under the excess workers' compensation insurance policies that it issued (the "Quota Share Agreement"). The Quota Share Agreement required Repwest to maintain Aggregate Excess of Loss reinsurance and pursuant to the Agreement, Repwest, Praetorian and Conestoga entered into an Aggregate Loss Reinsurance Contract in which Repwest, Praetorian and Conestoga were the cedent with Praetorian as the sole reinsurer (the "Aggregate Contract"). The Quota Share Agreement and Aggregate Contract contained identical arbitration provisions providing that "[a]s a condition precedent to any right of action hereunder, any dispute arising out of this Contract shall be submitted to the decision of a board of arbitration . . ."

The Quota Share Agreement was terminated with respect to Conestoga in 1996 and with respect to Praetorian in 1997. Thereafter, Praetorian and Conestoga entered into a commutation agreement to commute Praetorian's liability to Conestoga as reinsurer under the Aggregate Contract without Repwest's consent. A dispute arose in 2008 when Praetorian refused to indemnify Repwest for amounts billed under the Aggregate Contract because of the commutation agreement. Repwest filed suit alleging that the commutation provision in the Aggregate Contract required Conestoga and Praetorian to obtain its consent before commuting and sought a declaratory judgment that the commutation agreement was invalid as a result. Repwest also brought claims for breach of duty of good faith and fair dealing and breach of contract against Praetorian.

Praetorian moved to compel arbitration in response to the complaint. Repwest objected to arbitration and argued that

the dispute arose out of the commutation agreement as opposed to the Quota Share Agreement or Aggregate Contract. Repwest also argued that Praetorian had agreed to litigate the dispute pursuant to a 2010 Tolling Agreement and 2011 Release Agreement entered into by the parties and that Praetorian had waived arbitration by failing to raise it during settlement discussions.

The district court rejected all of Repwest's arguments, holding that the fact that part of the relief Repwest is seeking relates to the commutation agreement does not change the fact that Repwest's claims arise out of Praetorian's alleged breach of the Quota Share Agreement and Aggregate Contract. The court further noted that the breach of contract and breach of duty of good faith and fair dealing claims required an interpretation of the underlying Quota Share Agreement and Aggregate Contract. With respect to the Tolling Agreement and Repwest's argument that it would only be necessary if the parties were agreeing to litigate the dispute, the court held that a statute of limitations defense can be raised and determined through arbitration and the fact that the parties entered into an agreement to toll the statute of limitations did not evidence an agreement to waive the right to arbitrate.

With respect to the Release Agreement, the court held that the dispute resolution provision requiring disputes to be resolved in state or federal court in California was not applicable to the dispute before the court because the Release Agreement specifically excluded the Quota Share Agreement and Aggregate Contract from being affected by the Release Agreement. Finally, the district court held that Praetorian's failure to discuss arbitration during settlement negotiations was not a waiver of the right to arbitrate, as there was no evidence to suggest that Praetorian denied the right to arbitrate or even suggested that litigation was the only option.

Additionally, the court held that Praetorian was precluded from arbitrating claims for negligent misrepresentation and fraudulent inducement as the basis for its demand for rescission because those are tort claims that do not arise under the con-

tracts. However, to the extent Praetorian was seeking rescission based on a breach of contract, such a claim was arbitrable.

Redux in Context:

- Where a claim requires the interpretation of an underlying reinsurance contract containing an arbitration provision but nonetheless seeks relief relating to a separate contract without such a provision, a court will likely compel arbitration of the claim as “arising under” the reinsurance contract.
- A statute of limitations defense can be raised in arbitration and the decision of a party to enter into an agreement to toll the statute of limitations for

certain claims during settlement discussions is not evidence that the party is agreeing to litigate or otherwise waiving the right to arbitrate.

- The mere failure to raise an arbitration requirement during settlement discussion does not constitute a waiver of the right to arbitrate.
- Tort claims that do not require the interpretation of a contract provision do not “arise under” a contract for purposes of arbitration, and seeking rescission on the basis of negligent misrepresentation or fraudulent inducement is therefore not subject to an arbitration provision for claims “arising under” a reinsurance contract.

Second Circuit Finds Error by District Court But Affirms Decision to Confirm Arbitration Award Where Parties Agreed to Submit Arbitrability Questions to Arbitrator

On August 8, 2012, the United States Court of Appeals for the Second Circuit affirmed the decision of the United States District Court for the Southern District of New York to confirm an arbitration award despite the district court’s improper refusal to determine whether the dispute was subject to arbitration without first finding clear and convincing evidence that the parties intended to submit that question to arbitration. Germany and Thailand signed a bilateral investment treaty in 2002 (the “2002 Treaty”), which provided that disputes concerning investments between one country and an investor of the other country may be resolved in arbitration at the request of either party. Pursuant to the 2002 Treaty, Walter Bau AG (“Walter Bau”) initiated arbitration against Thailand in 2005 claiming that Thailand had unlawfully interfered with investments made by its predecessor. An arbitration tribunal was convened in accordance with the Terms of Reference signed by representatives of Walter Bau and Thailand. The Terms of Reference empowered the tribunal to “consider . . . objections to jurisdiction.”

After Thailand objected to jurisdiction, the arbitration tribunal conducted a hearing and issued an opinion unanimously con-

cluding that it had jurisdiction because the dispute concerned “approved investments” within the meaning of the 2002 Treaty. The arbitration tribunal ultimately awarded Walter Bau over 30 million euros in damages, costs and expenses. When Walter Bau petitioned the district court to confirm the arbitration award, Thailand moved to dismiss the petition and again argued that the arbitration panel did not have jurisdiction. The district court concluded that it did not need to conduct a de novo review of the award because the issue of whether the dispute involved “approved investments” was an issue of the scope of the arbitration agreement. The district court performed a deferential review of the tribunal’s jurisdictional determination and confirmed the award.

On appeal, the Second Circuit held the “question of whether the parties have submitted a particular dispute to arbitration, i.e., the question of arbitrability, is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise.” Accordingly, the circuit court concluded that the question of whether the district court properly declined to make an independent determination of whether the dispute involved “approved investments” turned on whether there was

clear and unmistakable evidence of the parties' intent to submit that question to arbitration. For this reason, the Second Circuit held that the district court erred when it refused to make an independent determination on the issue of arbitrability.

Despite the district court's error, the circuit court confirmed the arbitration award on appeal because there was clear and unmistakable evidence in the record that the parties intended to arbitrate questions of arbitrability. Pursuant to the Terms of Reference, the parties agreed to the UNCITRAL Arbitration Rules as the rules of procedure, which rules expressly provide that an "arbitration tribunal shall have the power to rule on objections that it has no jurisdiction." The Second Circuit has previously held that the incorporation of the UNCITRAL rules into a bilateral investment treaty was clear and unmistakable evidence that the parties intended questions of arbitrability to be decided by the arbitration tribunal. Accordingly, Thailand was not entitled to an independent court adjudication of whether the dispute involved "approved investments" that were subject to arbitration.

Additionally, the Second Circuit clarified its prior holding with respect to the UNCITRAL rules, in which it concluded that parties clearly and unmistakably intend to refer questions of arbi-

trability to the arbitrators "in the first instance" when they incorporate the UNCITRAL rules. In response to Thailand's argument that the phrase "in the first instance" limited the holding of the prior decision, the circuit court explained that its prior holding "necessarily means that a district court considering whether to confirm the award must review the arbitrators' resolution of such questions with deference."

Redux in Context:

- The question of arbitrability is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise.
- Incorporation of the UNCITRAL arbitration rules is clear and unmistakable evidence that the parties intended to submit the question of arbitrability to the arbitrators in the first instance.
- When there is clear and unmistakable evidence that the parties intended to submit the question of arbitrability to the arbitrators in the first instance, a district court deciding whether to confirm an arbitration award must conduct a deferential review of the arbitrators' determination of arbitrability.

District of New Jersey Grants Summary Judgment on Late Notice Defense and Calculation of Retention Under Retrocessional Agreements

On September 28, 2012, the United States District Court for the District of New Jersey granted summary judgment to a reinsurer with respect to the late notice defense raised by its retrocessionaire and as to the calculation of retention, holding that the retrocessionaire could not prove prejudice as a matter of law and the reinsurer's retention under the applicable retrocession agreements was calculated from the ground up. Munich Reinsurance America, Inc. ("Munich") entered into an excess of loss reinsurance agreement with Everest National Insurance Company ("Everest") to reinsure Everest's workers' compensation insurance program (the "Everest Agreement").

Under the Everest Agreement, Munich was required to indemnify Everest up to \$750,000 for losses in excess of \$250,000. Munich then purchased retrocessional coverage with limits of \$500,000 per claim for losses in excess of \$500,000. American National Insurance Company ("American National") acted as the retrocessionaire for a period of time from 2000 to 2001 pursuant to two separate retrocessional agreements (the Retrocession Agreements").

A dispute arose when American National refused to pay its share of certain claims under the Retrocession Agreements.

American National claimed that prompt notice of certain claims was a condition precedent to payment and that it was absolved of its duty to indemnify because of Munich's failure to report claims in accordance with the Retrocession Agreements. American National further claimed, among other defenses, that Munich's retention should be calculated on a net retained basis, such that American National was only required to pay the portion of any claim in excess of \$750,000.

The district court held that timely notice was not a condition precedent to payment by American National. The applicable provision required Munich to advise American National "promptly of all claims coming under this Agreement" and provided that "[a]n omission on the part of the Company to advise the Reinsurer of any loss shall not be held to prejudice the Company's rights hereunder." The court concluded that by using the terms "any" and "all," this provision expressly covers each and every claim covered by the Retrocession Agreements, including the subcategory of claims for which Munich Re was required to provide immediate notice pursuant to the subsequent provision. Moreover, citing the Third Circuit's recent decision in *Pacific Employers Insurance Co. v. Global Reinsurance Corp. of America*, — F.3d —, Nos. 11-3234, 11-3262, 2012 WL 3871588 (3d Cir. Sept. 7, 2012), the district court held that the subsequent provision requiring immediate notice did not contain any language indicating it was a condition precedent to payment.

Because timely notice was not a condition precedent, the court held that American National must show prejudice resulting from the delay in order to be relieved of its indemnification obligations. The district court determined that American National failed to meet its burden of proving prejudice because its only evidence of prejudice was an affidavit offered solely to defeat summary judgment which was contradicted by the affiant's prior deposition testimony. The court disregarded the affidavit because there was no independent evidence to bolster the contradictory statements and no explanation for the discrepancies.

The district further held that Munich's retention should be calculated on a ground up basis as opposed to a net retained basis. The dispute over the calculation of retention turned on

the interpretation of a provision in the Retrocession Agreements that American National shall not be liable for any loss until Munich's "ultimate net loss" exceeds \$500,000. American National argued that this meant Munich alone must pay \$500,000 before American National is required to provide indemnity. Munich, on the other hand, argued the "ultimate net loss" was defined by the Retrocession Agreements to mean the amounts actually paid or payable by Munich and Everest, such that American National must provide indemnity when Munich and Everest together have paid \$500,000. The district court held that American National's interpretation was unreasonable because it would produce an absurd result, i.e., that Munich purchased \$500,000 in retrocessional coverage from American National but American National would never be required to pay more than \$250,000 toward any claim. Accordingly, the court adopted Munich's interpretation and concluded that Munich's retention must be calculated from the ground up. Further, the district court held that even if the retention provision was ambiguous, the extrinsic evidence clearly established that retention should be calculated from the ground up because the underwriter of the Retrocession Agreements testified that was her intent and American National's expert agreed with Munich's interpretation in his deposition.

The district court denied cross motions for summary judgment on American National's rescission counterclaim, which was based on Munich's failure to disclose its internal analysis of the profitability of the Everest program. American National argued that Munich's internal analysis was material and that it would not have entered into the Retrocession Agreements at the given rate had it known about Munich's analysis. Munich disputed the materiality of its internal analysis and argued that it was only required to provide American National with the same data and information that it received from Everest for American National to perform its own analysis of the risks associated with the Everest program. The court recognized that it must apply a two-part test: whether American National reasonably would have considered the undisclosed information to be material and whether Munich should have known that American National would consider it material. Because there was competing evidence as to both parts of this test, the district court refused to grant summary judgment to either party. The district court likewise refused to grant summary judgment

to Munich on the basis of American National's waiver of the right to rescind by failing to promptly raise the defense. Again, the court concluded that there were not undisputed facts to support waiver as a matter of law.

Redux in Context:

- Under New York law, a reinsurer must prove prejudice to avoid its indemnity obligations on the basis of late notice unless timely notice is a condition precedent to payment.
- Under New York law, a notice provision in a reinsurance agreement will not be construed as a

condition precedent unless there is clear expression of the parties' intent to create a condition precedent.

- Courts applying New York law will not interpret reinsurance contracts to produce an absurd result where a cedent could never receive the benefit of the coverage it purchased.
- In the context of a claim for rescission under New York law, materiality is generally a question of fact reserved for the finder of fact absent clear and substantially uncontradicted evidence.

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