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The Increasingly Visible Hand of the Reinsurer in Insurance Coverage Disputes

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The parties to a mass tort insurance coverage dispute have never been the only ones with a significant interest in its outcome. Direct insurers have relied on reinsurers to spread their own risk. In the past, in cases where a reinsurer has a significant amount at stake, it may have influenced an insurer's behavior in litigation or settlement somewhat invisibly. Recently, however, reinsurers have been stepping into the spotlight and having a significant direct impact on the resolution of disputes with direct insureds.

Many policyholders may not consider that their own insurers, with whom they have purchased millions of dollars of insurance coverage, have attempted to cover their own risk by purchasing reinsurance for that coverage. Should the policyholder enter coverage litigation with its insurer, the actions of the reinsurer (with whom that policyholder never contracted) can often control how the insurer behaves in that litigation, and, more recently, the reinsurer's own behavior has become an issue in the litigation. Generally, there are three scenarios regarding the reinsurer as it pertains to insurance coverage disputes:

1. Discovery of reinsurance information when Reinsurer is not involved in insurance coverage litigation

Even if the reinsurer is not directly involved in the insurance coverage litigation, it can be still be useful for the policyholder to pursue evidence regarding reinsurance during discovery. In most insurance coverage litigation, the amount of the risk that is reinsured, and the reinsurers' identities, are veiled behind a wall of secrecy. Although a policyholder would prefer to gain access to information regarding the reinsurer's role during discovery, insurers regularly challenge a policyholder's attempts to obtain discovery into these issues.

While some courts allow discovery regarding the reinsurance agreements themselves, courts frequently limit this discovery to cases where monetary damages are at stake in the litigation and may completely restrict this access in pure declaratory judgment actions. Discovery of communications between the insurer and reinsurer may be even more challenging to obtain. Whether a court grants such discovery may depend on the relevance of those communications to the issues present in the litigation.

2. Reinsurer pursued directly if insurer acts as "passive intermediary"

In certain insurance coverage cases, the policyholder may want to pursue a direct action against the reinsurer. If an insurer is insolvent or faces great risk of insolvency, or there is another reason that an insurer cannot be pursued, the policyholder may be able to litigate against the reinsurer directly. The general rule is that an insured cannot sue a reinsurer directly due to a lack of contractual privity. However, there is a body of case law which allows a policyholder to sue the reinsurer directly if the insurer assumes the role of passive or nominal intermediary for the reinsurer, and the reinsurer engages in direct dealings with the policyholder.

If the reinsurer assumes a more active role, based on the course of dealing between the reinsurer and the insured, courts have held that the reinsurer is acting as insurer and can therefore be sued as an insurer. This course of dealing can include but is not limited to reinsurer involvement in underwriting, accounting, receipt of premiums, receipt of claims, and communications with the insured. See *World Omni Fin. Corp. v. ACE Captial Re, Inc.*, 2002 WL 3101669, *2 (S.D.N.Y. Sept. 10, 2002), vacated on other grounds, 64 Fed. Appx. 809 (S.D.N.Y. 2003) (denying reinsurer's motion to dismiss for lack of privity because insurer was nominal intermediary and never intended by either party to be the actual insurer). Moreover, certain types of reinsurance policies, known as "assumption reinsurance," where the reinsurer steps into the shoes of the ceding insurer, assumes its liabilities, and receives all premiums directly, have also been held to provide a cause of action for the insured against a reinsurer.

3. Reinsurer interfering with relationship between policyholder and insurer

In many recent asbestos and pollution cases, however, reinsurers, and particularly those who have entered what's known as a "retroactive reinsurance agreement" with the insurer, have taken over pre-existing contractual relations and sometimes caused disruption in them. In a retroactive reinsurance agreement, the reinsurer assumes full responsibility for a subset of the carrier's claims (typically all asbestos or environmental claims or both) in exchange for a lump-sum premium payment from the insurer (often taken from the reserves set aside by the insurer to pay claims). The reinsurer also assumes collectability risk for third-party reinsurance related to those claims, and its obligation is often capped at a pre-determined amount.

Such an arrangement can have far-reaching effects on the coverage dispute between insurer and policyholder. Reinsurers generate profit from these arrangements from the investment return on the direct insurers' premium payment from the time it is received until the time when the reinsurer must pay claims (or what is known as "float"). For this reason, the reinsurer will attempt to delay paying such claims as long as possible in an attempt to maximize its investment. In fact, some reinsurers may make claim payment determinations based on their

own cash flow targets rather than the legal obligations under the insurance contracts. Extended coverage litigation undertaken by counsel with whom the reinsurers have significant volume discount arrangements can benefit the reinsurer by increasing the float.

Other improper reinsurer activities under these agreements may include: (1) disruption of existing coverage-in-place, defense cost sharing, and other settlement agreements; (2) taking potentially frivolous litigation positions; and (3) inducing insurers to violate obligations to policyholders, including the sharing of privileged and confidential policyholder information with the reinsurer.

Despite the fact that the retroactive reinsurance agreements themselves may be deemed proper—many of these agreements receive regulatory approval from state insurance commissioners—policyholders can seek redress in litigation for the insurer's and reinsurer's improper activities under the agreements. Based on the improper activities outlined above, policyholders have successfully pursued claims against reinsurers and insurers for claims including tortious interference, unfair trade practices, bad faith, and breach of contract related to these activities. Of course, each policyholder's unique circumstances, the jurisdiction where the claim arises, and the specific actions of the reinsurer or insurer would need to be considered in evaluating whether such an action would be successful.

In summary, there are three main categories of reinsurer involvement that should be pursued in insurance coverage litigation: (1) even if there is no direct involvement in the litigation by the reinsurer, discovery should be sought regarding reinsurance; (2) an insured should examine its files to determine how actively involved the reinsurer has been in the underwriting and claims handing and whether direct action is appropriate; and (3) when the reinsurer is actively interfering in the policyholder-insurer relationship after it has been established, the insured may be able to take separate action against the reinsurer to prevent such behavior.