New York High Court Confirms No Blanket Rule on Reinsurance Limits

The Situation: This past month, the New York Court of Appeals considered whether New York law imposes a "rule of construction" or "strong presumption" that a reinsurance contract's limit of liability provision caps the reinsurance available for defense costs.

The Result: Declining to adopt a blanket rule, the New York high court determined that the amount of reinsurance for defense costs provided by a reinsurance contract is to be determined on a case-by-case basis in accordance with traditional rules of insurance contract interpretation.

Looking Ahead: Reinsureds should not assume that generically titled "limitation of liability" and "reinsurance accepted" provisions cap the reinsurance available for defense costs and should instead carefully review the precise language of their reinsurance certificates.

Does a reinsurance contract's limit of liability cap the total amount of reinsurance available for defense costs, even where the reinsured policy covers defense costs outside of policy limits? In recent years, this question has generated considerable disagreement among reinsureds and their reinsurers, as well as differing outcomes by the courts to have addressed this issue.[1] In December 2017, in the closely watched *Global Reinsurance Corporation of America v. Century Indemnity Company*, No. 124, 2017 WL 6374281 (N.Y. Dec. 14, 2017) ("*Global Reinsurance*"), the New York Court of Appeals confirmed that the answer under New York law continues to depend upon the particular language of the parties' reinsurance agreements.

Declining to adopt a blanket rule or presumption, the New York Court of Appeals cautioned that generically titled "limitation of liability" and "reinsurance accepted" provisions must not be assumed to cap the total reinsurance available for defense costs. Instead, the determination of the amount of reinsurance available for defense costs must be made upon an evaluation of the precise language of the reinsurance certificate, construed in accordance with traditional rules of insurance contract interpretation.

Background

Global Reinsurance Corporation of America ("Global") had issued a series of facultative reinsurance certificates to Century Indemnity Company ("Century") between 1971 and 1980, which reinsured part of Century's liability under general liability policies sold to its policyholder, Caterpillar Tractor Company ("Caterpillar").

When thousands of lawsuits were brought against Caterpillar alleging bodily injury resulting from asbestos exposure, Century became obligated to indemnify Caterpillar for its asbestos liability up to the policies' respective limits. Per the terms of the general liability policies, Century was also required to reimburse Caterpillar for its defense costs, which were not subject to the policies' limits.

After Century paid more than $60 million to Caterpillar—approximately 90 percent of which for Caterpillar's defense costs—Century sought reimbursement from Global, when their reinsurance dispute ensued. Century and Global fundamentally disagreed as to whether the reinsurance certificates' per-occurrence limits of liability capped Global's reinsurance obligations for Caterpillar's defense costs.

The Global certificates stated that reinsurance was provided "subject to" either the "amount of liability" or "limits of liability" set forth in the certificate. Each certificate further contained a "Reinsurance Accepted" section listing a specific dollar amount ranging from $250,000 and $2 million. The certificates did not, however, expressly address whether defense costs were subject to or outside of these stated limits.

In Global's view, the amount stated in the certificates' "Reinsurance Accepted" provisions capped the maximum amount that it could be obligated to pay for *both* indemnity payments and defense costs combined. Century disagreed, contending that the certificates' "Reinsurance Accepted" provision applied *only* to indemnity payments and not to defense costs. Century maintained that, because Global had agreed to "follow the fortunes" of Century and "be subject in all respects to all the terms and conditions" of the general liability policies—pursuant to which Century was liable to Caterpillar for defense costs above policy limits—Global was accordingly liable to Century for its proportionate share of those defense costs above the certificates' "Reinsurance Accepted" limit.

The Southern District of New York Applies *Bellefonte*

Unable to resolve their dispute, Global commenced suit in New York federal court in September 2013, seeking, among other relief, a declaration that the certificates' "Reinsurance Accepted" provisions capped its total reinsurance liability for both indemnity payments and defense costs. In August 2014, the district court granted Global's motion for partial summary judgment.

Relying principally upon prior decisions of the Second Circuit and New York Court of Appeals finding that defense costs and other expenses were subject to the limit of liability provisions of what it considered to be "nearly identical" reinsurance certificates—*Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co.*, 903 F.2d 910 (2d Cir. 1990) ("*Bellefonte*"); *Unigard Security Ins. Co. v. North River Ins. Co.*, 4 F.3d 1049 (2d Cir. 1993) ("*Unigard*"); and *Excess Ins. Co. Ltd. v. Factory Mut. Ins. Co.*, 3 N.Y.3d 577 (N.Y. 2004) ("*Excess*")—the district court concluded that the "unambiguous language" of the Global certificates' "Reinsurance Accepted" provisions capped Global's reinsurance obligations for both indemnity payments and defense costs.

The Second Circuit Questions *Bellefonte*

On appeal in late 2016, however, the Second Circuit cast doubt upon its prior decisions relied upon by the district court, including the so-called *Bellefonte* rule. In *Bellefonte*, the Second Circuit had determined that a reinsurer was not obligated to pay its reinsured for defense costs above the limits of liability stated in the reinsurance certificate. While *Bellefonte* had involved reinsurance for a liability policy whose limits included defense costs, the Second Circuit thereafter expanded its *Bellefonte* "cap" ruling in *Unigard* to a reinsured liability policy that paid defense costs outside of policy limits.

While noting that "the economic impact of a reversal of the *Bellefonte-Unigard* rule may counsel in favor of retaining the status quo," the Second Circuit agreed that Century's argument that *Bellefonte* and *Unigard* were "wrongly decided" was "not without force." Calling into question the reasoning of its *Bellefonte* ruling, the Second Circuit found "it 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 to the "Reinsurance Accepted" provision of the *Bellefonte* certificate, which the district court below had concluded contained language "nearly identical" to the "Reinsurance

Accepted" provision of the Global certificates, the Second Circuit acknowledged that "it is not entirely clear what exactly [the provision] meant."

The Second Circuit further observed that treating a "Reinsurance Accepted" provision as "an absolute cap on the reinsurer's liability for both loss and expense"—particularly where the reinsured policy covers defense costs outside of policy limits—"seems to be in tension with the purpose of reinsurance," which is "to enable the reinsured to spread its risk of loss among one or more insurers." The Second Circuit explained that such a rule could permit a reinsurer to receive a percentage of the reinsured's premium, without also accepting an equal percentage of the reinsured's risk, potentially leaving defense costs "entirely unreinsured."

The Second Circuit also did not find the New York Court of Appeals' decision in *Excess* to be controlling. Unlike *Global Reinsurance*, which concerned reinsurance for a policyholder's own defense costs, *Excess* concerned the separate question of whether a reinsurer was obligated to pay an insurer's own expenses incurred in a coverage dispute with its policyholder.

Nevertheless, the New York Court of Appeals in *Excess* had relied upon the Second Circuit's decisions in *Bellefonte* and *Unigard*, which some viewed as creating a blanket rule under New York law that the liability cap in a reinsurance certificate limits a reinsurer's liability for *all* litigation expenses, including an underlying policyholder's defense costs.

Given the potential uncertainty created by *Excess*, the Second Circuit certified to the New York high court the threshold question of whether New York law "impose[s] 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 reinsured policy covers defense costs outside of policy limits.[2]

The New York Court Of Appeals Confirms No Blanket Rule on Reinsurance Limits

This past month, a unanimous New York Court of Appeals answered this certified question. Acknowledging that *Excess* did not address whether the amount of reinsurance available for an underlying policyholder's defense costs is capped by the liability limit in a reinsurance certificate, the New York high court clarified that: "New York law does not impose either a rule, or a presumption, that a limitation on liability clause necessarily caps all obligations owed by a reinsurer, such as defense costs, without regard for the specific language employed therein."

The New York Court of Appeals further emphasized that its ruling in *Excess* "did not supersede the standard rules of contract interpretation otherwise applicable to facultative reinsurance contracts," or "permit a court to disregard the precise terminology that the parties used and simply assume … that any clause bearing the generic marker of a 'limitation on liability' or 'reinsurance accepted' clause was intended to be cost-inclusive." Instead, the court explained that the determination of the amount of reinsurance available for defense costs must be made upon an evaluation of the precise language of the reinsurance certificate, construed in accordance with standard rules of insurance policy interpretation.

Without addressing the *Bellefonte* and *Unigard* rulings or the proper construction of the Global reinsurance certificates themselves, the Court of Appeals returned the matter to the Second Circuit for decision.

Four Key Takeaways

1. In its recent *Global Reinsurance* decision, the New York Court of Appeals declined to adopt a blanket rule or presumption in reinsurance limits disputes, confirming that outcomes will continue to depend upon the particular language of the parties' reinsurance agreements.

2. Having called into question the reasoning of its earlier *Bellefonte* and *Unigard* decisions, the Second Circuit will be provided with a fresh opportunity to construe the Global reinsurance certificates in 2018. Whether the Second Circuit will, in fact, depart from or distinguish these prior rulings when interpreting the Global certificates remains to be seen.

3. Regardless of *Global Reinsurance*'s ultimate disposition, however, the New York Court of Appeals has made clear through its most recent pronouncement of New York law that the reinsurance available for defense costs must continue to be decided on a case-by-case basis in accordance with traditional principles of insurance contract interpretation such as *contra proferentem*.

4. Reinsureds—as well as companies whose captive liability insurance programs are reinsured under certificates governed by New York law—accordingly should not assume that generically titled "limitation of liability" or "reinsurance accepted" provisions necessarily cap the reinsurance available for defense costs and will instead be well served to carefully review the specific language of their reinsurance contracts.

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[1] *Compare Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co.*, 903 F.2d 910 (2d Cir. 1990) (finding that reinsurance certificates' limits of liability capped total reinsurance available for defense costs); *Unigard Security Ins. Co. v. North River Ins. Co.*, 4 F.3d 1049 (2d Cir. 1993) (same), *with Utica Mut. Ins. Co. v. Munich Reinsurance America Inc.*, 594 Fed. Appx. 700 (2nd Cir. 2014) (vacating district court's summary judgment award in favor of reinsurer, where reinsurance certificate was ambiguous as to whether its limit of liability included defense costs); *Utica Mut. Ins. Co. v. R & Q Reinsurance Co.*, No. 6:13–CV–1332 (BKS/ATB), 2015 WL 4254074 (N.D.N.Y. June 4, 2015) (denying reinsurer's motion for partial summary judgment, where language of reinsurance certificates was ambiguous as to whether defense costs are included within certificates' limit of liability); *Century Indem. Co. v. OneBeacon Ins. Co.*, No. 1280 EDA 2016, 2017 WL 4639578 (Oct. 17, 2017), *reargument denied* (Dec. 22, 2017) (in matter of first impression under Pennsylvania law, affirming trial court's determination that reinsurance certificates did not unambiguously cap reinsurer's liability for defense expenses and award in favor of reinsured following bench trial).

[2] The Second Circuit certified the following question to the New York Court of Appeals: "Does the decision of the New York Court of Appeals in *Excess Insurance Co. v. Factory Mutual Insurance Co.*, 3 N.Y.3d 577 (2004), impose 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?"