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Reinsurance: Bad Faith Considerations and Insolvency Dilemma

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by

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INTRODUCTION

A contract of reinsurance is one by which an insurer contracts with a third person to insure him against loss or liability by reason of such original insurance.[1] In a very real sense, a reinsurer is an insurance company's insurer. Just as an individual consumer will pay to insure himself against catastrophic financial loss, so will an insurance company surrender a portion of its premiums to a reinsurer in order to obtain protection from exceptional or unforeseen losses.[2] Reinsurance is accomplished by way of contract of indemnity and may either be on an individual risk basis or on the basis of the assumption of certain lines or classes of business. Reinsurers produce their business either by directly soliciting primary insurers or by the acceptance from a small number of specialized reinsurance intermediary firms which structure and place reinsurance programs. The most rudimentary purpose of reinsurance is to disperse or spread the risk of loss, but reinsurance also serves a variety of subsidiary functions which are indispensable to the life of an insurance company. Reinsurance can be utilized to increase the undrewriting capacity of an insurance company; it can also serve to stabilize the underwriting

1. Cal. Ins. Code 620 (West 1972)
2. Thompson, Critical Issues of the Eighties: How Trends in Reinsurance Will Affect Legal, Legislative, and Regulatory Actions, 16 Forum 1038 (1981)

result of an insurance company by paying its losses incurred over a fixed retention.[3]

Traditionally, the reinsurance relationship is frequently characterized as an exercise of fiduciary responsibility based upon an undertaking of utmost good faith between contracting parties whose fortunes are interdependent. Nevertheless, disputes arise as in any commercial endeavor. Litigation involving reinsurance between the parties to the reinsurance contract has been particularly rare. Most of the litigation that has been between reinsurers and persons not party to the reinsurance agreement. Perhaps most notable is litigation prompted by the insolvency of a party to the reinsurance agreement.[4]

This thesis first discusses the relationship between reinsurer and reinsured. Particular attention is focused on:

(a) whether the duty of disclosure in the reinsurance context rises to a "fiduciary" duty.

(b) issues concerning reinsurers involvement in the defense of claims, and

(c) liability of reinsurer to reimburse ceding company for losses resulting from ceding company's failure to perform contractual obligation.

Additionally, the thesis recognizes that courts are increasingly prone to allow punitive damage claims and uphold punitive damage awards.[5]

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3. Id. at 1040
4. Franklin W. Nutter, Reinsurance In The Liquidation Of Insolvent Insurers, 18 Forum at 290
5. Donald W. Rees and Carol E. Reese, Reinsurance: The Basic and Bad Faith Considerations, 39 FICC Q at 343 (1989)

When ceding insurers ask their reinsurers to contribute to the payment of punitive damage assessed against the former for its bad faith in the settlement or defense of a claim, conflicts frequently arise. There are two types of punitive damage awards for which a ceding company may request reimbursement. The first type is an award of punitive damages against the insured; the second type is an award against the ceding company, typically for bad faith.[6]

The second major area of analysis in this thesis concerns several basic reinsurance-related issues stemming from the insolvency of insurers. When a ceding company is unable to pay insurance proceeds to its insureds or to third party claimants as a result of insolvency, such parties often seek to recover reinsurance proceeds directly from the reinsurer. However, reinsurance is an indemnity relationship in which persons not party to the reinsurance agreement have no interest and are not privy. The insolvency of the reinsured does not affect this fundamental premise.

Finally, this thesis discusses the insolvency dilemma that the insurance industry has encountered in recent years and examines some possible options available to reinsurers and reinsureds in their efforts to stabilize their practices in the reinsurance business. When disputes involving reinsurance arise, the parties to reinsurance contracts have resorted first to negotiations. Where they fail, contracts more commonly require the parties to arbitrate their differences. However, there are still some disadvantages in reinsurance arbitration. Where arbitration fails, the parties to a

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6. Id.

reinsurance contract may litigate. The decisions whether to include an arbitration clause in a contract and what provision to put in it, and whether to take advantage of arbitration once a dispute arises are not simple. Given the number of insolvencies over the past few years, and the likelihood that a dispute will arise after liquidation, the right to arbitrate disputes after insolvency has become an important issue to reinsurer.

CHAPTER 1

The Relationship Between Reinsurer and Reinsured

Reinsurers assume a part of the risk assumed by their reinsured. They insure insurers. The reinsurance relationship is a contractual relationship whereby the reinsurer undertakes to indemnify the reinsured for liability incurred under a contract of insurance. The reinsurance relationship is often characterized as undertakings of utmost good faith between contracting parties. Under traditional reinsurance arrangements the primary insurer remains fully and directly liable to the underlying insured for the full coverage of the policy, notwithstanding the reinsurance contract. Based on this principle, the reinsured company has the sole responsibility and discretion to defend or settle suits or claims, while the reinsurer usually retains a right to associate in the defense of any action. The ceding company's duty to defend and investigate and its obligation to advise the reinsurer of all claims and subsequent developments which might involve the reinsurer, taken together with the reinsurer's right to associate, constitutes the basis for the reinsurer's emerging oversight activities.

A. Utmost Good Faith

Contracts of reinsurance are of "utmost good faith."[7] Inherent in the concept of " utmost good faith" is the duty of the reinsured to disclose all known information material to the risk.[8] Once a reinsurance agreement is executed, the dealings between the parties are not generally at arms-length. In many ways the ceding carrier is in a more advantageous position than the reinsurer in that the reinsurer's relationship is with the ceding company only. The reinsurer generally has no contact with the insured while the ceding company usually has firsthand knowledge of the type and quality of the business being written. Furthermore, the ceding company is usually intimately involved in the handling of claims. The reinsurer must rely upon the reinsured to properly reserve the claim and give timely notice to the reinsurer where appropriate. In Northwestern Mut. Fire Ass'n v. Union Mut. Fire Ins. Co. of Providence, the court found that the reinsurer "must depend upon the knowledge, judgment, diligence and good faith of the ceding company in investigating and appraising the risk, placing the original insurance and making investigations and adjustments in the event of loss, ".[9] It then held that the ceding company owed to the reinsurers an obligation of the highest good faith.

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7. See Security Mutual Gas. Co. v. Affiliated Fm Ins. Co., 471 F.2d 238, 246 (8th Cir 1972)
8. California Insurance Code 622 (West 1972) provides:
Where an insurer obtains reinsurance, he must communicate all the representations of the original insured, and also all the knowledge and information he posses, whether previously or subsequently acquired, which are material to the risk.
9. See Northwester Mut. Fire Ass'n Union Mut. Fire Ins. Co. of Providence, R.I., 50 F.Supp. 785, 788 (W.D. Wash. 1943)

The duty of disclosure may depend on the kind of reinsurance at issue. In general, there are three basic forms of reinsurance: excess, facultative, and pro rata.[10] Under facultative reinsurance, a ceding company may offer the reinsurer any individual risk, which the reinsurer is free to accept or reject[11] That arrangement provides flexibility to both the reinsurer and the ceding company. The reinsurer can select the types of risk it is willing to accept, and the ceding company can accept greater- and a wide variety of - primary risks.[12] Additionally, facultative reinsurance can serve to limit the potential exposure of the ceding company and its other reinsurers.[13] Excess and pro rata reinsurance agreements, usually classified as treaties,[14] are obligatory in nature. Under pro rata treaties, a ceding company and its reinsurer share premiums and losses in some proportion. Excess treaties, on the other hand, are concerned with the amount of loss, to the extent that losses in excess of some agreed-upon retention or deductible are paid by the reinsurer.[15] In the case of facultative reinsurance, the duty requires the disclosure of " facts ordinarily known at the time concerning the insurance risk of the property or interest to be reinsured."[16] However, the negotiation of a reinsurance treaty will commonly precede the cession of individual policies under the treaty. Therefore, in most instances, the

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10. Green, Risk And Insurance 176-178 (3d ed. 1973)
11. Moore, Reinsurance- Sharing the Risk, Brief, May 1980, at 15
12. Id. at 16
13. Id.
14. Greene, note 10 supra, at 177
15. Greene, note 10 supra , at 177-78
16. Strain (ed.) , Reinsurance 6 (1980) at 10

underwriting information required to be disclosed during treaty negotiations must be in " general and anticipatory terms."[17]

A reinsurance contract may be invalidated by a ceding company's misrepresentation, just as in a contract of original insurance.[18] However, misrepresenting a fact will not affect the validity of a transaction unless the fact misrepresented is considered material. A fact is considered material to a reinsurer if its misrepresentation deprives the reinsurer of its opportunity to accept or reject the ceding company's proposal. However, a mere nondisclosure of material facts does not provide a basis for rescission of the reinsurance contract unless it is fraudulent.[19]

Whether the duty of disclosure in the reinsurance context rises to a " fiduciary" duty is clear. Recent case law suggests that a court may be inclined to find that a fiduciary relationship exists between a reinsurer and its reinsured where treaty, rather than facultative reinsurance, is involved. In American Re-Insurance Co. v. MGIC Investment Corp.,[20] the ceding company sought reinsurance for a lease guarantee program. After conducting the preliminary actuarial study used to derive a premium rate for the program, the ceding company learned that the actuary's findings had omitted a key factor, resulting in a lower rate. Additional actuarial studies were undertaken which disclosed that a higher premium rate was necessary to the success of the program. When the cedent presented the details of the program

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17. Id.
18. Carter, Reinsurance 119 (2d ed. 1983)
19. See General Reinsurance Corp. v. Southern Surety Co. of Des Moines, Iowa , 27 F. 2d 265, 273 (8th Cir. 1928)
20. No. 77 CH1457 (Ill. Cir. Ct. Cook County, Ch. Div. Oct. 20, 1987)

to the reinsurer, it disclosed only the initial actuarial report reflecting the lower premium charge. In finding that" utmost good faith is an element of a fiduciary relationship in which one's word is deemed to be trustworthy,"[21] the court reasoned that the fact that the reinsurance involved was treaty reinsurance inherently required Am-Re to place its trust in the reinsured. As such, the ceding company had a duty of full disclosure, which it breached when it misrepresented the actuarial study regarding the premium rate. In the court's view, the ceding company also had a duty to keep the reinsurer apprised and informed about the types of risks that were being reinsured and the ceding company's plans, goals, and operations, which it also failed to do.

Rejecting the reinsured's argument that it owed merely a duty of good faith and fair dealing, and not a fiduciary duty to Am-Re, the court explained:

> The dealings between Am-Re and the defendants were not at armslength. Only the reinsured close the risks to be reinsured by Am-Re; Am-Re accepted these risks in good faith.... Am-Re had no power of choice. Control was in the hands of the reinsured.... The success or failure of the treaty lay in the acceptance of risks which was essentially the sole responsibility of the reinsured. This treaty, therefore, could not exist without trust, without the imposition of a fiduciary duty between the parties. The nature of the treaty required Am-Re to place a grate deal of trust in the integrity of the reinsured.[22]

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21. Id. at 40
22. Id. at 42-43

Even if a court is unwilling to find the existence of treaty reinsurance, it may be inclined to find such a relationship as to at least some aspects of the treaty. In Mutuelle Generale Francaise Vie v. Life Assurance Co. of Pennsylvania,[23] which involved treaty reinsurance, the federal court found that the reinsurer had alleged sufficient facts in its first amended complaint to support a finding that the ceding company had a fiduciary duty as to the administration of the ceded business. Under the treaty, the ceding company was responsible for providing information on the policies, forwarding the premiums, and investigating and paying claims. The reinsurer had no control over the issuance of the policies, and no contact with the policyholders, and was therefore entitled to place its highest faith in the ceding company with respect to the administration of its treaty responsibilities.

In determining whether a fiduciary relationship existed, the district court, sitting in diversity, looked to Illinois case law for an appropriate test:

> Such a fiduciary relationship may be presumed from the very relationship of the parties... or may be found to exist in a particular situation where confidence is reposed on one side and there is a resulting superiority and influence on the other side.[24]

Utilizing this test, the court concluded that the ceding company maintained a dominant and influential position in carrying out its reporting and administrative obligations. However, the court refused to find that a fiduciary relationship existed as to the selection of the policies to be reinsured, because the cedent was compelled to cede

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23. 688 F.Supp. 386 (N.D. Ill. 1988)
24. Id. at 386 , 398 (N.D. Ill. 1988)

those policies specifically defined in the treaty. According to the court, the ceding company's responsibilities in the selection process were effectively ministerial so there was no resulting position of superiority or influence to establish a fiduciary duty. The court distinguished MGIC Investment, wherein a fiduciary relationship was found to exist between the reinsurer and cedent with regard to the selection process, because there, the ceding company had total control over the risks to be reinsured under the treaty, and the reinsurer had no choice but to place a great deal of trust in the ceding company.

The district court in Mutuelle was careful to note that, with the exception of MGIC Investment which has no real precedential value, Illinois courts have not yet addressed whether a fiduciary duty always exists between a ceding company and a reinsurer.[25] Conversely, in Morrison Assurance Co. v. North Am.Reinsurance Corp.,[26] where facultative reinsurance was involved, the court rejected the argument that a confidential relationship always exists by and between a reinsurer and its reinsured, finding instead that parties to a reinsurance relationship are experienced and sophisticated companies dealing at arm's length. Consequently, the court conclude that no confidential or fiduciary relationship between the ceding company and its reinsurer.

Every contract contains an implied covenant of good faith and fair dealing. The implications of the covenant of good faith and fair

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25. Jonathan F. Bank And Karean L. Bizzini, "Fraud" in the Context of Reinsurance, 40 FICC Q at 131 (1990)
26. 588 F. Supp. 1324, 1328 (N.D. Ala 1984)

dealing have not been the subject of many decisions dealing with reinsurance. In American Re-Insurance Co. v. MGIC Investment Corp.,[27] the court has suggested that there is a distinction between the duty of utmost good faith and the covenant of good faith and fair dealing.

In Central National Ins. Co. of Omaha v. Prudential Reinsurance Co.,[28] the court reversed the trial court's holding that the reinsurer had breached the implied covenant of good faith and fair dealing.[29] The court found that tort demands are not recoverable against a reinsurer for breach of the implied covenant of good faith and fair dealing.[30]

B. Reinsurer's Involvement in the Defense of Claims

Typically, the reinsurance contract provides that although the ceding carrier retains control of any claim, suit or proceeding, the reinsurer is allowed at its own expense the opportunity to associate in the defense and control of any such claim, suit or proceeding which may involve the reinsurance with the full cooperation of the reinsured. This is commonly referred to as the"claims cooperation" clause. An example of the type of provision commonly found in reinsurance agreements which grants to the reinsurer the "right to associate" in the defense of underlying claims may be in words or substance, as follows:

> While the reinsurer does not undertake to investigate or defend claims or suits, it shall nevertheless have the right and be given

27. No. 77 CH 1457 (Ill. Cir. Ct., Cook County, Ch. Div. Oct. 20, 1987)
28. 196 Cal. App. 3d 1319 (1987)
29. Id. at 362
30. Id. at 359

> the opportunity to associate with the reinsured and its representatives at the reinsurer's own expense in the defense and control of any claim, suit, or proceeding which may involve this reinsurance with the full cooperation of the reinsures.[31]

Most commonly, the reinsurance contract provides that the ceding carrier is to provide to the reinsurer "prompt notice... of any occurrence or accident which, without regard to liability, appears likely to involve this reinsurance...." In general, "prompt" notice as required in notice clauses has been interpreted to mean that notice must be given in " a reasonable time under the circumstances."[32] Failure by the ceding company to give such reasonable notice generally bars the recovery of reinsurance proceeds.[33]

The reinsurer's motivation for increasing its involvement in a ceding company's claim and defense activities is evident. Reinsurer's involvement in a claim or case, by contract or by its actions, will be so significant as to invalidate the lack of privity to persons not party to the reinsurance agreement, thereby subjecting the reinsurer to direct liability. The reinsurer may also become subject to statutory and civil standards for claim settlement practices, or a legal relationship with the ceding company not originally contemplated by the agreement is established.[34] However, there is case law to guide the reinsurer into the safe limits of involvement. In Peerless Casualty Co. v. Inland Mutual Ins.,[35] the court found the reinsurer to be a joint venture with

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31. Donald W. Rees And Carol E. Reese, Reinsurance: The Basic and Bad Faith Considerations, 39 FICC Q at 330 (1989)
32. 13A Appleman, Insurance Law And Practice 7697 at 551 (1976ed)
33. Id.
34. Franklin W. Nutter, 34 FICC Q at 153 (1984)
35. 251 F. 2d 696 (4th Cir. 1958)

the ceding company on the basis of a "follow the fortunes" clause in the contract. The court acknowledged that the reinsurer undertook no unusual actions with respect to the claim; however, the reinsurer's failure to exercise its right to associate counsel with the ceding company placed it in a position of having the ceding company's negligence imputed to it. Contrasted to this, however, is the case of Employers Reinsurance Corp. v. American Fidelity Co..[36] Again, the reinsurer was not involved in the claim determination; however, the court found no liability because the contract did not contain "follow the fortunes" language and there was no factual evidence of a joint venture.

A "follow the fortunes" clause is quite common in reinsurance contracts, sometimes referred to as "follow the settlement" clause. Such clauses mean that the reinsurer has agreed to abide by any settlement made by the original insurer. The rational of such clauses is to do away with the need to prove a loss under the original insurance contract. This clause served a very practical purpose. "Follow the fortunes" clauses are intended to preclude reinsurers from objecting to or questioning the validity of good faith settlements made by reinsureds in cases where there is no dispute as to coverage of the underlying claim under the original policy.

Although the reinsurer has historically played a passive role in the defense of underlying insurance claims, reinsurers today should and increasingly do seek to assert their rights to participate in the defense of such claims.[37] Because of the increasing complexity of

36. 196 F.Supp. 553 (W.D. Mo. 1959)
37. Sullivan, Reinsurance in the Age of Crisis, 38 FICC Q. at 21

coverage and claims, the heightened judicial scrutiny of the reinsurers' role, and the economic necessity of monitoring reserves, it is becoming more and more necessary for them to do so.[38]

C. Liability of Reinsurer to Reimburse Ceding Carrier for Losses Resulting from Ceding Carrier's Failure to Perform Contractual Obligation

Courts in states throughout the country have recognized numerous different causes of action which are available to insureds or their assigns who contend that their carrier has not fulfilled its contractual obligations. Such theories of recovery vary from the more traditional concepts of negligent failure to settle or failure of counsel to act in the best interest of the insured as opposed to the insurer, to the more recently recognized causes of action of breach of the carrier's implied duty of good faith and fair dealing to the insured, violation of a state's consumer protection statute, and violation of a state's insurance code. When faced with claims by the insured that it has not fulfilled its contractual obligations, the ceding carrier often looks to its reinsurer for support and ultimately reimbursement. More and more often, arbitration panels and courts are being asked to determine whether damages imposed against an insurer as a result of its failure to properly perform its contractual obligations are covered by the reinsurance contract.[39]

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38. Id. at 119
39. Keith Drummond And W. Neil Rambin, Common Consideration For Counsel Representing Reinsurers, 39 FICC Q. at 179

Despite the frequency of claims by reinsureds for reimbursement from their reinsurers for damages incurred as a result of their own misdeeds, there are very few judicial opinions regarding the validity of such claims. This presumably results from the historical reluctance of insurers and reinsurers to pursue disputes into the courts. Most reinsurance disputes which are not resolved amicably are submitted arbitration panels pursuant to mandatory arbitration clauses in their reinsurance contracts.

In at least two cases courts have held that damages assessed against the ceding carrier for its failure to honor its contractual obligations is not the type of loss which comes within the purview of a typical reinsurance contract.[40] As explained by one commentator, the typical reinsurance contract covers only that liability which the ceding carrier assumes under the insurance policies it writes,including punitive damages, but not damages which are assessed against the ceding carrier for something it did or did not do in the handling of the claim.[41]

Even though the reinsurer is not generally liable for the ceding carrier's misdeeds, some reinsurance contracts expressly provide for reinsurance coverage for certain types of damages and/or liabilities which might be assessed against the reinsured as a result of its wrongful conduct. Such coverage includes what has come to be called the "judgement in excess of policy limits" clause, which is designed to define the basis of a reinsurer's participation in losses in excess of the

40. Employers Reinsurance Corp. v. American Fidelity & Casualty Co., 196 F. Supp. 553 (W.D. Mo. 1959); Duber Industrial Security, Ins. v. Allendale Mutual Ins. Co., 2d Civ. No. 69133 (Cal. App., 2d Dist., Feb. 16, 1984)

41. Hanger, Punitive Damage- Insurance and Reinsurance, 47 Ins. Couns. J. 72,75 (1985)

original policy limits. Often it describes a reinsurer's obligation for or exclusion of punitive damages.

Other senariors might arise where the ceding carrier can successfully argue that the imposition of compensatory and/or punitive damages for its misdeeds are reinsured. A number of reinsurance contracts contain a "follow the fortunes" clause. The purpose of such a clause is to prevent a reinsurer from second-guessing the discretionary decisions which the reinsured must often make in the handling of a claim. A ceding carrier might certainly argue the clause's presence precludes the reinsurer from denying liability for additional losses incurred as a result of actions of the ceding carrier in the handling of a claim which where taken in good faith to reduce exposure to both the ceding carrier and the reinsurer. On the other hand, it has been said that while the "follow the fortunes" clause is designed to require that the reinsurer respond in circumstances not expressly contemplated in the reinsurance contract, it is not intended to encompass activities of the reinsured which are actionable.[42]

Suppose the reinsurer is fully informed of the significant developments of the handling of the underlying claim and either actively or passively consents to same. Can it then be argued that the reinsurer should reimburse the ceding company? Once the reinsurer becomes involved in the claims handling process and either directs or consents to the reinsured's conduct, the reinsured can argue that it is only appropriate that the reinsurer bear its portion of the consequences of same. In Peerless v. Inland Mutual Ins. Company, the

42. Dowd, Punitive or Extra-Contractual Award Against Insurers: The Reinsurer's Role, 28 FIC. Q. 281, 284 (1978)

inclusion of the "follow the fortunes" clause and the participation of the reinsurer did lead the court to affirm a judgment against a reinsurer by a ceding carrier. The ceding carrier was seeking reimbursement for a portion of an excess-of-policy-limits award which it became liable to pay its insured as result of its failure to settle a third party claim. In light of the "follow the fortunes" clause and the reinsurer's informed acquiescence in the settlement decisions of the ceding carrier, the court concluded that the sound and unsound decisions of the reinsured became those of reinsurer. Thus the reinsurer was bound along with the ceding carrier, and the liability of the reinsurer was to follow that of the reinsured.[43]

D. Punitive Damages

A major source of contention between reinsurers and reinsured arises when ceding insurers ask their reinsurers to contribute to the payment of punitive damage awards.[44] The question of whether a reinsurance contract provides coverage for punitive damages depends upon the terms and provisions of the reinsurance agreement and the underwriting policy. In other words, if the underlying policy does not cover punitive damages, then the reinsurer will not be liable under the reinsurance agreement to the reinsured who pays punitive damages on behalf of its insured.[45] A related issue is whether the reinsurance agreement covers damages assessed against the reinsured for the latter's torts in the handling of underlying claims. Whether punitive

43. Id. at 704
44. Sullivan, note 37 supra, at 14
45. Id. at 15

damages are covered under a particular reinsurance contract ultimately rests on the insurability of such damages. In many states, the preclusion of insurance for punitive damages applied only to intentional conduct and only ten states hold punitive damages uninsurable for non-intentional conduct. Of those ten states, six permit insurability of punitive damages where vicariously imposed. Restated, only four states absolutely preclude the insurability of punitive damages.[46]

There are two types of punitive damage awards for which a ceding company may request reimbursement. The first type is an award of punitive damages against policyholders; the second type is an award against the ceding company, typically for bad faith.[47]

1. Punitive Damages Assessed Against Policyholders

In Central National Ins. Co. of Omaha v. Prudential Reinsurance Co.,[48] the court held that payment of claims excluded under the original policy is a valid defense to a reinsurer's liability under the reinsurance contract. A "follow the fortunes" clause does not preclude the reinsurer from asserting that the claims are excluded from coverage under the reinsurance contract.[49] In Pru-Re, the ceding company paid a settlement of an underlying action against its insured in which compensatory and punitive damages were awarded at trial. Prudential Reinsurance, one of the reinsurers of the underlying policy,

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46. John W. Morrison, Punitive Damages And Why the Reinsurer Cares, 20 Forum 1987, at 74
47. Donald W. Reese And Carol E. Reese, note 31 supra, at 343
48. 196 Cal. App. 3d 342
49. Id. at 353

denied any liability under the reinsurance contract to the ceding company on the grounds that the damages awarded were excluded by the underlying policy and thus, in turn, were not covered by the reinsurance contract.

Prudential Reinsurance filed a declaratory relief action, which was consolidated with the subsequently filed action of the ceding company against the reinsurer for breach of contract and bad faith. The breach of contract and bad faith action was tried first. At the trial, the court prevented Prudential Reinsurance from raising the payment of excluded claims as a defense on the basis that its denial of coverage amounted to a waiver of its right to dispute subsequent settlements made by the ceding company.[50] The declaratory relief action was dismissed. In reversing the trial court's exclusion of the evidence relating to the reinsurer's defense of payment of excluded claims, the Pru-Re court noted:

> The extent of a reinsurer's liability is determined by the language of the reinsurance contract. Once a reinsured sustains a loss, "a debt from the reinsurer to the reinsured arises on the loss. The case stands between them upon the terms of the policy and the facts connected with the loss at the time the reinsurers are sued, and the reinsurer may make the same objections and raise the same defenses which the reinsured could in a suit on the primitive policy."[51]
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> A reinsured's payment to its insured is not in and of itself determinative of a reinsurer's obligation to indemnify its

50. Id. at 352
51. Id. at 353

reinsured.... A settlement of excluded claims does not necessarily bind the reinsurer, even where, as here, the reinsurer had denied coverage and filed a declaratory relief action. The burden of separating the covered claims from the excluded claims rests with the reinsured under the terms of this reinsurance contract, and not with the reinsurer. The contract permits the reinsurer to require the reinsured to present satisfactory proof of covered claims.[52]

Similarly, in American Ins. Co. v. NACPAC,[53] the court held that a "follow the fortunes" clause did not obligate a reinsurer to reimburse the reinsured for any portion of a settlement of a punitive damage award excluded under the insurance policy and reinsurance agreement. In the underlying action, a jury awarded compensatory and punitive damages against the original insured. While the award was on appeal, the ceding company settled the case and requested reimbursement from its reinsurer of that portion of the settlement within the reinsurer's liability limits under the reinsurance agreement. The reinsurer denied coverage under the reinsurance agreement for any portion of the settlement.

In the ceding company's district court action in NACPAC against the reinsurer, the reinsurer defended on the ground that the underlying policy and therefore the reinsurance agreement did not cover punitive damages assessed for intentional corporate misconduct.[54] Further, since the part of the settlement attributable to

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52. Id. at 357
53. 697 F. 2d 79 (2d Cir. 1982)
54. Id. at 80

payment of compensatory damages, which was covered under the reinsurance agreement, was below the stated retention, the reinsurer contended that it had no duty to reimburse the ceding company for any portion of the settlement.[55] The district court agreed and held that the reinsurer owed nothing to the reinsured under the reinsurance agreement.[56] The second Circuit in NACPAC affirmed the district court's ruling and noted that despite a "follow the fortunes" clause in the reinsurance agreement, "it would be unfair to the reinsurer to hold it liable for damages beyond the scope of its policy."[57]

In light of the Pru-Re and NACPAC decisions, the ceding company may not blindly rely on "follow-the-fortunes" clauses in cases involving questionable coverage. A more prudent course of action in such cases is to consult with the reinsurer in advance of paying settlements of doubtful claims to avoid the expense and effort of needless litigation.

2. Bad Faith and Punitive Damages Assessed Against Ceding Company

The focal point for much of the reinsurers' concern is the problem of extracontractual damages. Generally, the problem arises when ceding insurers ask their reinsurers to contribute to the payment of punitive damage assessed against the former for its bad faith in the settlement or defense of a claim. The fundamental economic question is whether coverage for extracontractual damages should be provided by reinsurers.[58] Much of the difficulty in this area

55. Id.
56. Id.
57. Id. at 81
58. Thompson, note 2 supra, at 1051

can be attributed to reinsurance contract draftsmanship. Reinsurance contracts are generally construed as covering contractual obligations only, in other words, if the primary insurance contract does not cover punitive damages, then a reinsurer will not be liable to a reinsured who pays punitives on behalf of its insured. Thus it is important that reinsurers draft agreements with the utmost care, so as to preclude reinsurer liability for damages they might ordinarily and not unreasonably regard as "extracontractual."

Insurers argue, however, that reinsurers should share in paying extracontractual damages because such exposure is a fact of life in the marketplace today.[59] They contend that insurers should not alone be required to pay these "new" costs associated with activities that benefit both the insurer and the reinsurer.[60] An unrelenting truth of recent tort doctrine has been the heightening standards of conduct for all types of professions and businesses, with the predictable increases in tort liability. Insurers have responded to those increases by paying contested claims and attempting to pass the costs along to their reinsurers.[61] Reinsurers, in turn, have withdrawn from the market.

For the most part, the general principle that the extent of a reinsurer's liability is governed by the language of the reinsurance contract applied to the issue of "bad faith" damages assessed against a ceding company. Thus, in Employers Reinsurance Corporation v. American Fidelity and Casualty Co., the court has held that unless the

59. Id.
60. Id.
61. Id.

terms of the reinsurance agreement or underlying policy provide for coverage of "bad faith" damages, a reinsurer will not be liable to its reinsured for such damages.[62] In this regard, the Employers court noted:

> Contractually, the reinsurance treaties... do not cover or deal with a factua' situation whereby liability is imposed upon the reinsurer for the ceding company's "bad faith" or negligent failure to settle a liability claim within the ambit of the ceding company's primary policy coverage when the ceding company has a reasonable opportunity to do so. The reinsurance treaties, like the primary policies to which they relate, are totally silent in respect to that matter. That is readily understandable because the premise for the ceding company's liability... to its insureds... for sums in excess of its policy coverage, and which it seeks to here pass on to the reinsurer is one imposed by the law of torts and not strictly for breach of contract.[63]

The Employers court rejected the ceding company's argument that the reinsurance agreement created a joint enterprise between the reinsurer and the ceding company.[64] Moreover, since the reinsurance agreement in question in Employers did not contain a "follow-the - fortunes"clause, the court also rejected the reinsured's contention that the reinsurer's liability "follow that of the reinsured in every case," as a matter of law.[65]

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62. See Employers Reinsurance Corporation v. American Fidelity and Casualty Co., 196 F. Supp. 553, 560 (W. D. Mo. 1959)
63. Id.
64. Id. at 561
65. Id. at 560-61

However, reinsurers may not necessarily be shielded from liability in every instance in which the reinsurance agreement is silent with respect to "bad faith' or punitive damages. For example, the presence of a "follow-the-fortunes" clause in the reinsurance agreement and a reinsurer's acquiescence in the defense strategy of the insured may provide a basis for imposing liability on the reinsurer for "bad faith" damages.[66]

In Peerless Insurance Co. v. Inland Mutual Insurance Co., an insured sued its liability insurer for negligence and bad faith in failing to settle a personal injury action against the insured within the policy limits. The insurer settled the bad faith action prior to its adjudication and sought to recover a portion of the cost of settlement and costs of defense of the bad faith action from its reinsurer. The reinsurance treaty at issue in Peerless provided that liability of the Reinsurer shall follow that of the Reinsured in every case..."[67]

Importantly, the reinsurer in Peerless was kept fully informed of the significant developments in the person injury action and was "freely and frankly consulted by the reinsured" as to whether to reject the personal injury plaintiff's offer to settle within the policy limits.[68] Further, the reinsurer did not seek to exercise its contractual right to be associated with the reinsured in the defense or control of the underlying suit, but "left the decision as to defense and settlement of the action in the reinsured's hands."[69]

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66. Peerless Insurance Co. v. Inland Mutual Insurance Co., 251 F. 2d 696 (4th Cir. 1958)
67. Id. at 697
68. Id. at 702, 704
69. Id. at 703-704

The Peerless court thus held that the reinsurer was bound by the reinsured's settlement decision in the underlying action and consequently, it was liable for a proportionate share of the settlement of the "bad faith" action.[70] Contrary to the finding in Employers,[71] the Peerless court held that the reinsurer and reinsured in those circumstances were engaged in a joint enterprise in defending the underlying action.[72]

In Ott v. All-star Ins. Corp.,[73] liability has been imposed on a reinsurer for "bad faith" damages assessed against the ceding company under an excess-of-policy-limits provision in the reinsurance agreement. The clause in question in Ott was added in an endorsement to the original reinsurance agreement and provided that:

> Should the Ceding Company become legally obligated to pay a loss in excess of its policy limits the Reinsurer agrees to assume seventy-five present of that part of such loss (plus proportionate loss expense) which is in excess of the policy limit. However, in the event the applicable policy limit is less than the Ceding Company's retention at the time of the loss, the amount hereby assumed by the Reinsurer shall be limited to seventy-five percent of that part of the loss (plus proportionate loss expense) which is in excess of said retention.[74]

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70. Id. at 704
71. Note 62, supra
72. Note 66, supra
73. 299 N.W. 2d 839 (Wisc. 1981)
74. Id. at 841

The clause did not expressly provide coverage for punitive or extra-contractual damages. The Ott court rejected the reinsurer's contention that the excess-of-policy-limits clause merely provided for additional reinsurance. Rather, the clause made the reinsurer the liability insurer of the ceding company.[75] As such, the excess-of-policy-limits clause "provided coverage for the ceding company's torts in connection with its relations with its own insureds."[76] The court noted that by the terms of the excess-of-policy-limits clause:

> The central risk against which the reinsured sought to be protected was the potential that the company might become liable in tort to one of its insureds for a bad faith or negligent failure to settle a claim within policy limits.[77]

By interpreting the excess-of-limits provision as constituting liability insurance rather than reinsurance, the Ott court reversed the lower court's dismissal of the underlying insured's 'bad faith" action against the reinsurer under Wisconsin's direct action statute. The variance in results found in these decisions emphasizes the need for reinsurers and ceding companies to draft reinsurance agreements with sufficient specificity so as to spell out their obligations with respect to extra-contractual damages.[78]

The insertion of excess-of-policy-limits clauses like the one in Ott v. All-star Ins. Corp.,[79] was one attempt to rectify this problem. Following the uncertainty left by the Employers and Peerless

75. Id. at 844
76. Id. at 848
77. Id. at 846
78. Sullivan, Reinsurance in the Age of Crisis, 38 FICC Q. at 15
79. Note 73 supra

decisions, many ceding companies sought express contractual coverage in the form of "excess of policy limits clause" added to reinsurance agreements to protect themselves against liability for "bad faith" judgments in excess of policy limits.[80] Accordingly, reinsurers should incorporate specific exclusions in their contracts if they do not intend to cover extra-contractual damages.

E. Primary Carrier's Duty to Excess Carrier

Clearly the new growth and development area for bad faith is in those disputes between primary and excess insurers. Given the development of actions for bad faith and disputes between excess and primary carriers, the question arises whether it can develop within disputes between the primary insurer and its reinsurer. Because the duty of good faith and the statutory remedies have subjected primary insurers to awards of extra-contractual damages, the question necessarily arises as to the excess carrier's responsibility when the monies awarded to the insured exceed the primary carrier's limits of liability. While the primary carrier looks to the excess carrier for any judgment amount in excess of the primary limits, the excess carrier frequently feels that the primary carrier mishandled the claim or wrongly failed to settle, resulting in a judgment in excess of the primary carrier's limits. In these situations, excess carriers have sought to impose liability back upon the primary carrier and avoid extra payment.

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80. 299 N.W. 2d at 845

1. Actions Constituting Bad Faith

Because there appears to be a cause of action by an excess carrier against the primary insurer, primary carriers must be especially cognizant of what constitutes bad faith. Basically, that which constitutes bad faith from the primary carrier to the insured constitutes bad faith to the excess carrier. However, there do seem to be some instances in which actions which would not constitute bad faith to the insured can constitute or at least contribute to a finding of bad faith to the excess carrier.[81]

The question that has occasionally arisen is whether a primary insurer's request or demand for contribution from its insured or the excess carrier is evidence of bad faith. This question becomes particularly acute where a settlement demand is within the primary carrier's policy limits, but the primary carrier uses the possibility of an excess judgment as leverage against the excess carrier. In Centennial Insurance Co. v. Liability Mutual Ins. Co.,[82] it was held that an attempt to induce an insured or its excess carrier to contribute to settlement can be evidence be bad faith, but that an attempt does not mandate a finding of bad faith. Further, whether such an action constitutes bad faith must be viewed and considered in light of the surrounding circumstances. The court held that the request for contribution did not constitute bad faith as the parties had negotiated in good faith and the request for contribution from the excess carrier was the

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81. Paul B. Butler, Jr. and Robert v. Potter, Jr., The Primary Carrier Caught In The Middle With Bad Faith Exposure To Its Insureds, Excess Carriers and Reinsurers, 24 Tort & Insurance Law Journal at 126

82. 404 N. E. 2d 759 (Ohio)

difference between the primary carrier's highest offer and claimant's lowest offer.

During the course of discussing whether an excess carrier can sue a primary carrier for recovery of an excess judgment, many courts have discussed the concepts of negligence and, therefore, many decisions can be found in which primary insurers are seemingly found liable to the excess carrier on the basis of negligent acts. However, the correct legal principles can only support liability where the primary carrier acts intentionally or with a very high degree of negligence such that its conduct can be considered grossly negligent or wanton and malicious.[83]

For instance, in Centennial Insurance Co. v. Liberty Mutual Ins. Co.,[84] a verdict was rendered which was $495,000 in excess of primary limits. While the primary carrier had offered to settle for $250,000 the claimant's lowest demand had been $275,000 and the primary carrier requested contribution from the excess carrier in an amount equal to the difference. Although the ultimate judgment was far in excess of policy limits, it was held that the primary carrier was not guilty of bad faith in that the difference between the settlement offer and the ultimate judgment was simply a mistake in judgment and evaluation.

For the most part, those cases which seem to hold that a primary carrier can be held liable for negligent acts involve situations where the handing of settlement negotiation and defense tactics are best described as nonresponsive or obviously unreasonable. In Peter v.

83. Paul B. Bulter, Jr. and Robert v. Potter, Jr., note 77 supra, at 127
84. 404 N.E. 2d 759 (Ohio 1980)

Traveler Ins. Co.,[85] trial resulted in a judgment and ultimate settlement in the amount of $387,984.10. While the primary insurer carried limits of $250,000 it refused an offer to settle within policy limits and offered only $150,000 to settle the case. The $150,000 offer was maximum authority held by the branch office and a breakdown in communications with the home office prevented any additional authority from ever being extended. This unresponsive conduct was held to be arbitrary, capricious and unreasonable. Likewise, bad faith or liability for excess judgments frequently occurs where the primary insurer simply fails to conduct an appropriate investigation or to provide a reasonable evaluation of the injuries.

The evaluation by the company's or insured's lawyer that policy limits will be exceeded, is in and of itself insufficient to constitute bad faith, but it is generally admissible and oftentimes substantial evidence of bad faith.[86] It has likewise been held that a refusal to settle or pay a claim upon the basis of advice of counsel cannot prevent a finding of bad faith.[87] However, where the recovery of punitive damages are sought, advice of counsel can be shown to rebut the applicability of punitive damages or in mitigation.[88] Furthermore, where malice is an essential element of the claim for bad faith, reliance upon advice of counsel may constitute a complete defense.[89]

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85. 375 F. Supp.10347 (C. D. Cal. 1974)
86. State Farm Fire & Casualty Co. v. De La Maza, 328 So. 2d 547 (Fla. 3d DCA 1976)
87. Flynn v. Nationwide Mut. Ins. Co. , 315 S.E. 2d 817 (S. C. 1984)
88. Wagenheim v. Alexander Grant & Co., 482 N.E.. 2d 955 (Ohio App. 1983)
89. Brownlee v. Pratt, 68 N. E. 2d 789 (Ohio App. 1946)

2. Avoid Bad Faith Exposure to Excess Carrier

Essentially, the steps that the primary carrier takes to avoid bad faith exposure to its insured are the same steps to be taken with respect to the excess carrier. However, because some courts are beginning to develop a direct fiduciary duty owed by the primary carrier to the excess carrier, there are some additional considerations which primary carriers must take.

As is the case with the insured, the primary insurer should give notice to the excess carrier of all significant developments and particularly of all settlement offers. The primary carrier should also strive to be particularly responsive to all questions and requests made by the excess carrier and should seek to make a full disclosure of all facts known. In several bad faith actions it has been noted as a matter of significance in favor of the primary carrier that the primary carrier was willing to open its claim file to the excess carrier during the course of litigation and settlement negotiations. While it may be tempting for excess carriers to note in their files the obvious exposure to and probability of an excess judgment, if they note these matters without fully reviewing the information possessed by the primary carrier, their statements will carry substantially less weight and will have the appearance of being self-serving. Such self-serving comments or correspondence can actually operate to the detriment of both the primary and excess carrier, particularly if they are discovered by the claimant's attorney who then realizes that his bargaining position is enhanced. While there are no existing cases in which the theory has been argued, the potential exists for the primary carrier to seek reimbursement from the excess carrier for the amount by which the excess carrier's self-serving statements served to increase the ultimate settlement value of the case. Obviously, there is a potential for abuse on both the side of the primary carrier and the excess carrier. The clear message from the courts is that they will seek to eliminate these abuses by allowing the primary and excess carriers to recover from the one most responsible.

Perhaps the most important step that a primary carrier can take in avoiding exposure to the excess carrier is to make and document realistic assessments of the potential judgment. As discussed above, careful analysis of legal principles and existing case law does not support the primary carrier's liability for bad faith based upon incorrect evaluations and good faith under assessments of the ultimate judgment. Accordingly, if the primary insurer can establish that its evaluations of the potential judgment were reasonable and based upon valid considerations, its chances of avoiding liability for an excess judgment substantially improve. To the extent that there is data or specific examples that support the primary carrier's evaluation of the loss, those should be included within the claim file and should also be disclosed to both the insured and excess carrier. Consideration can be given in the appropriate case to the possibility of obtaining the opinion of an outside consultant.

Liability for an excess judgment will not be imposed upon the primary carrier because it was unable to reach a consensus with the insured and excess carrier, but only if its assessment is deemed unreasonable or in bad faith. Moreover, by disclosing the basis for the primary carrier's assessments, the excess carrier may implicitly accept those bases unless it refutes them with other substantive information. This exchange can only create additional information upon which assessment can be made. There has been considerable discussion as to whether the primary insurer must subordinate its best interests to that of the insured or the excess carrier. The case law only rarely states that a primary insurer must subordinate its own interests. Rather, the majority rule seems to be that the primary carrier must only give good faith consideration to the insured's or the excess carrier's interest. Some courts have specifically stated that if there is any factual basis for denying liability, the carrier is privileged to litigate its liability without fear of "bad faith."[90] Accordingly, the primary insurer is entitled to consider its own interests, but it simply cannot place its own interests ahead of its insureds or of the excess carriers. The ultimate test of bad faith seems to be that set forth in Continental Casualty Co. v. United States Fidelity and Guarantee Co.,[91] and Crisci v. Security Ins. Co,[92] in which the courts held that the test of bad faith was whether an insurer without policy limits would have accepted the settlement offer. This test can be expanded to cover all situations by asking whether the steps taken by the insurer would have been taken had the matter been exclusively within the control of an insured with the financial resources sufficient to satisfy any possible judgment.

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90. Tyson v. Safe Co Ins. Co., 461 So. 2d 1308 (Ala. 1984) Hyiggins v. Blue Cross of W. Iowa, 319 N. W. 2d 232 (Iowa 1982) Hoskins v. Aetna Life Co., 452 N. E. 2d 1315 (Ohio 1983)
91. 516 F. Supp. 384 (N.D. Cal.1981)
92. 426 P. 2d 173 (Cal. 1963)

CHAPTER 2

Issues of Insolvency

The economic turmoil in the international insurance and reinsurance markets has ensured that a significant number of insurers and reinsurers have recently become insolvent. When an insurer becomes insolvent, its assets must be liquidated in accordance with state statutes. This chapter concentrates on what would happen if a reinsured were unable to pay claims made upon it.

A. The Insolvency Clause

A reinsurance agreement is one by which the reinsurer indemnify the ceding company for losses paid. The insolvency clause is a contractual exception to the indemnity nature of the reinsurance agreement. The insolvency clause allows the liquidator or receiver of the insolvent insurer to collect from the reinsurer the amount that would have been due if the ceding company had not become insolvent and had paid the claim. As a result of the indemnity nature of the contract, it is a constant and uniform principle of law in this country that the original insured cannot enforce an insurer's contract of reinsurance and is not a third-party beneficiary to that contract. Therefore, no privity exists between the reinsurer and the insured or persons claiming through him, under or by reason of the contract of reinsurance.[93] Claimants to reinsurance assets have no common law or statutory right unless the reinsurance agreement so provide.

In Fidelity & Deposit Co. v. Pink, [94] the primary insured was insolvent and the quota share reinsurer contended that the contract was one of indemnity which required that reinsurer reimburse the liquidator only for the appropriate proportion of the losses actually paid by the liquidator to claimants. The liquidator contended that he should be reimbursed the appropriate proportion of the primary company's liability to claimants regardless of the amount the insolvent company was able to pay the claimants. Based on the language of the reinsurance agreement, the Supreme Court found for the reinsurer. Since Fidelity & Deposit Co. v. Pink, regulators have initiated legislation to assure that reinsurers would pay reinsurance proceeds based on the total liabilities of the insolvent company rather than on the total payment to claimants. Subsequent to the Fidelity & Deposit Co. v. Pink decision, regulators sought statutory means of requiring that in the event of the insolvency of a primary company, reinsurers would be obligated to pay reinsurance proceeds based on the liability of the ceding company, as determined in the liquidation proceeding, notwithstanding the indemnity nature of the reinsurance contract. At the prompting of state insurance departments, most states have adopted statutes, regulations, rules or practices that prohibit credit for reinsurance unless the reinsurance agreement contains a provision stating that in the event of the insolvency of the ceding company, the

93. Couch on Insurance, 2d, 80 at 66; Nutter, Reinsurance Issues in the liquidation of Insolvent Insurers, 18 Forum 290, 291, (1983)
94. 302 U. S. 224 (1937)

reinsurer shall pay reinsurance proceeds to the domiciliary liquidator based on the liability of the ceding company, as established in the liquidation proceeding, regardless of whether or not the liquidator can pay fully such liability.[95]

The effect of such statutes has been to require an "insolvency clause" in reinsurance agreements. Without such a clause, the ceding company would not be able to take credit for the reinsurance in its statutory financial statements, which is an important reason for the acquisition of reinsurance.[96] The effect of the insolvency clause is to preserve the assets of the estate of the insolvent company.

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95. See the Model Insolvency statute recommended by the Reinsurance Association of America:
No credit shall be allowed, as an admitted asset or deduction from liability, to any ceding insurer for reinsurance, unless the reinsurance contract provides, in substance, that in the event of the insolvency of the ceding insurer, the reinsurance shall be payable under contract or contracts reinsured by the assuming insurer on the basis of the claims allowed against the ceding insurer in the insolvency proceedings, without diminution because of the insolvency of the ceding insurer, directly to the ceding insurer or to its domiciliary liquidator or receive except: (a) where the contract specifically provides another payee of such reinsurance in the event of the insolvency of the ceding insurer or (b) where the assuming insurer with the consent of the direct insured or insureds has assumed such policy obligations of the ceding insurer as direct obligations of the assuming insurer to the payees under such policies and in substitution for the obligations of the ceding insurer to such payees.

The domiciliary liquidator or receiver of an insolvent ceding insurer shall give written notice of the pendent of a claim against such ceding insurer on the contract reinsured within a reasonable time after such claim is filed in the insolvency proceeding. During the pendent of such claim is to be adjudicated any defenses which it deems available to the ceding insurer, its liquidator or receiver. Such expense shall be chargeable subject to court approval against the insolvent ceding insurer as part of the expense of liquidation to the extent of a proportionate share of the benefit which may accrue to the ceding insurer solely as a result of the defense undertaken by the assuming insurer. Where two or more assuming insurers are involved in the same claim and a majority in interest elect to interpose defense to such claim, the expense shall be apportioned in accordance with the terms of the reinsurance agreement as though such expense had been incurred by the ceding company.

96. Skandia Am. Reins. Co. v. Schenk, 441 F.Supp. 715 (S.D.N.Y. 1977)

B. The Relationship Between Reinsurance Proceeds And State Guaranty Funds

The creation of the insurance guaranty associations in the early 1970s has resulted in considerable litigation involving reinsurance and insolvent insurers. These guaranty funds assume the obligations of an insolvent company to its insureds by fulfilling the policy obligations of the insurer up to a statutory limit. After the claims of policyholders are paid, the fund, like other creditors, is reimbursed from the assets of the insolvent company in accordance with statutory priorities.

The primary argument advanced by the funds is that they are the "statutory successor" to the insolvent company and, by reason of the insolvent's reinsurance contracts, are entitled to direct payment of reinsurance proceeds. In response, reinsurers have complied with the widely used standard insolvency clause contained in most reinsurance contracts which requires payment to the "liquidator, receiver or statutory successor" upon the insolvency of the reinsured. The funds have relied on language in their enabling legislation "deeming" them to be the insurer to the extent of the insolvent's obligations. The courts have rejected this interpretation and have instead construed it as a limitation on the funds' authority. In Skandia America Reinsurance Corp. v. Schench, Superintendent of Insurance,[97] it was held that the deeming language was a limitation on the funds' general obligations to pay covered claims. The courts have held that the language merely meant that the fund could assert all the rights and policy defenses available to the insurer in fulfilling its obligation.[98]

97. 441 F. Supp. 715 (S.D.N.Y. 1977)
98. General Reinsurance Corp. v. Missouri Gen. Ins. Co., 458 F. Supp. 1 (W.D. Mo. 1977)

The major reason for the rejection of the "statutory successor" argument is its direct and irreconcilable conflict with the remainder of the liquidation scheme. Related code provisions endow only the domiciliary liquidator with authority to administer the estate and garner all assets, which include reinsurance proceeds. More troublesome is the statutory priority accorded the funds in the distribution of these assets. Where the statute expressly gives the fund the position of a fifth-level creditor, it is incongruous to provide it with a means to bypass the entire process. In sum, granting the fund such a preference does violence to the remainder of the liquidation law.[99]

Equitable theories of recovery have been advanced but have received even less consideration. Funds contend that they are equitably subrogated to the rights of the policyholder, whose claims they have paid. Although this is true, it does not follow that the fund has a right of action against the reinsurer. In Excess and Casualty Reinsurance Association v. Insurance Comm'r of California, the Ninth Circuit Court of Appeals noted, "Because a claimant has no rights against the reinsurance company, neither does the Guaranty Association in the claimant's shoes."[100]

Lastly, the funds have maintain that public policy entitles them to the direct payment of reinsurance proceeds. The funds have argued that it is necessary to protect the public and keep policyholder premiums from increasing to cover fund assessments on insurers. Both arguments are too narrow in vision. The funds are only a small

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99. Skandia Am. Reinsurance corp. v. Schench, 441 F. Supp. 715 (S.D.N.Y. 1977)
100. 656 F. 2d at 496.

part of a liquidation process that attempts to balance the needs of multiple parties. Public policy requires that this balance, achieved through a careful procedure and priority system, be enforced. A guaranty fund exception to this system would benefit one creditor at the expense of many others and disrupt a distribution process upon which all creditors rely for prompt payment.[101]

The legal challenges brought by guaranty funds seeking direct payment of reinsurance proceeds outside the liquidation process have resulted in the reaffirmation of established principles of insurance law. Notwithstanding the public service which the guaranty funds perform, they also have prompted a restatement of support for the uniform liquidation of insurers.

From their viewpoint reinsurers have comprehensive judicial support for the integrity of reinsurance contract clauses denying third party rights in the contracts and for compliance with insolvency clause requirements to pay proceeds to statutory liquidators. State insurance officials as receivers will receive reinsurance contract proceeds in a manner consistent with the treatment of reinsurance as a general asset for the reduction in liabilities on financial statements. Lastly, guaranty funds can pursue reinsurance proceeds within the receivership as an early source of funds available for the payment of claims and to relieve the burden of assessments.[102]

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101. Supra note at 495.
102. Nutter, Insurance Insolvencies, Guaranty Funds, and Reinsurance Proceeds, 29 Fed. Ins. Coun. Q.373 (1979)

C. Exceptions to the Insolvency Clause

The New York statute requires that insolvency clauses state that the reinsurance proceeds need not be payable to the liquidator where the reinsurance agreement specifies another payee of such reinsurance in the event of the insolvency of the ceding insurer; and the assuming insurer with the consent of the direct insureds, has assumed such policy obligations to the payees as a replacement for the obligations of the ceding insurer.[103]

The first exception noted above allows an endorsement to the reinsurance agreement called the cut-through endorsement. A cut-through endorsement to a reinsurance contract allows payment of reinsurance proceeds directly to the original insured in the event of the ceding company's insolvency. A cut-through endorsement used by one reinsurer provides:

> In the event [the ceding company] fails to pay, within the time provided in the above identified policy, any loss thereunder for which [the ceding company] is legally liable, [the reinsurer] for value received agrees hereby that it will immediately become liable for 100 percent of said loss and will make payment thereof at once directly to the parties named in said policy, or otherwise as their respective interest may appear.
>
> The undersigned covenant that this agreement takes precedence over any other reinsurance agreement, contract or arrangement between them to the extent that [the reinsurer] shall not be subject to duplicate liability because of any

103. 1308 (2)(B)(i) and (ii) of the N.Y. Ins. Code.

payments made under the terms hereof.

[The reinsurer] reserves the right to cancel this agreement upon notice to the parties named in the above identified policy as required by the policy.[104]

Typically, this endorsement is requested by a mortgagee or insured who is not satisfied with the financial rating of the ceding company. The cut-through endorsement merely redirects to the insured or mortgagee reinsurance proceeds otherwise payable to the liquidator, pursuant to the insolvency clause, in the event of the insolvency of the ceding company. A cut-through is not technically a novation, substituting the reinsurer for the insurer on the original policy, nor is it an assumption certificate whereby the reinsurer assumes all policy obligations of the insurer and, thus, relieves it completely.

Some regulators have questioned the use of the cut-through endorsement because it gives a preference in liquidation to the beneficiaries of the endorsement and is unfair to other claimants who receive a lesser portion of their claims when assets are distributed. In 1977 the largest insurer in Puerto Rico was declared insolvent. Subsequent events identified several reinsurers which had issued cut-through endorsements. Arguments were made that traditional principles of reinsurance law were applicable and that the reinsurance due the insolvent was a general asset of the estate payable solely to the insurance commissioner. It was asserted that, for public policy reasons, the cut-through did not survive the insolvency of the insurer.

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104. Donald W. Reese And Carol E Reese, Reinsurance: The Basic and Bad Faith Considerations, 39 Fed'n Ins & Corp. Coun. Q 1990 at 337

The Superior Court found, however, that the cut-throughs survived the insolvency and that the reinsurers were directly liable to policyholders holding valid endorsements. The court also relieved the guaranty fund of its obligation to pay where a valid cut-through was issued to the policyholder.

A variation of the cut-through endorsement is the guarantee endorsement whereby the reinsurer, in the event of insolvency, guarantees payment of some or all of the primary company's obligations. When Best's ratings decline, many primary companies request cut-through and guarantee endorsements or bonds from reinsurers. Given the administrative problems attendant to such endorsements, regulatory disfavor and the credit risk, many reinsurers restrict the use of these endorsements.

Another exception to the New York statute requiring an insolvency clause for reinsurance credit is the assumption agreement.[105] This usually takes the form of a novation by which one company agrees to assume the obligations and liabilities of the original insurer to the insured, i.e., replaces the original insurer. The original insurer is released from its liabilities to the insured. In order for there to be a true novation, the insured must consent to the substitution of insurers since the insured's right to choose an insurer is impacted.

It may be questioned whether the assumption agreement truly is a reinsurance transaction since it involves replacement of insurers rather than a traditional transfer of a portion of a risk from an insurer

105. See 1114 (c) of the N.Y. Ins. Code.

to a reinsurer. Nonetheless, the form of such a transaction is usually that of an assumption and reinsurance of certain obligations for specified consideration.

Aside from the three abovementioned exceptions to the insolvency clause, there may exist an extra contractual obligation clause in a reinsurance agreement which may not be reinsurance and, therefore, may not fall within the ambit of the insolvency clause. An extra contractual obligation arises separately from the coverage of any insurance policy reinsured and results from tortious conduct of the insurer in the course of policyholder service or claim handling pursuant to such insurance policy. An excess judgment, a type of extra contractual obligation, is a loss in excess of the policy limit, the insurer being liable for such excess due to mishandling of the claim. Extra contractual obligations may include both compensatory and punitive damages.

D. Direct Action

Where a primary insurance company becomes insolvent, claim payments cease for the period of time necessary for the liquidator to take control and for the guaranty funds to obtain and review the claim files. Thereafter, payment of claims becomes problematical. A guaranty fund will pay a claim which falls within the lines of business and limits stated in the fund's enabling legislation. Those claims not paid at all or in full by the guaranty fund are referred to the liquidator. The public depends on insurance to fund its personal and business losses. When an insurance company is unable to so fund losses due to insolvency, insureds experience a serious economic inconvenience.

For this reason, some insureds and claimants seek to collect reinsurance proceeds directly from reinsurers.

Direct actions undercut the statutory scheme of liquidation adopted in most states[106] and are contrary to the indemnity nature of the reinsurance contract. As a result, a body of case law has developed which demonstrates that absent an intent to benefit directly or create rights in insureds or other third parties, reinsurance proceeds are payable only to the domiciliary liquidator. The bases upon which the courts have reached this conclusion are explored below.

1. Direct Action Claims by Insureds and Claimants

a. Agency Relationship

A novel approach to avoid the liquidation estate of an insolvent insurer is the argument that the insurer is merely the agent of the reinsurer. Under this theory the reinsurer becomes liable to the claimant outside and independent of the liquidation proceedings. To succeed on this legal theory, a claimant must overcome considerable legal precedent: the indemnity nature of the reinsurance contract and lack of privity with the insurer. The traditional and stated reason to deny direct actions against reinsurers is the lack of privity with the reinsurer. An insured or claimant is not a party to the reinsurance agreement and the insured does not enter into an insurance contract

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106. The NAIC Insurers supervision, Rehabilitation, and Liquidation Model Act, in 1 (d) (3) and (4), states as purpose of the act " enhanced sufficiency and economy of liquidation" and "equitable apportionment of any unavoidable loss." The liquidator is directed to marshall and preserve the assets of the insolvent insurer [21 (A)(6)] and reduce the assets to a degree of liquidity necessary for distribution [25(B)]. Claims and other debts are paid out based on a specific priority[42] which assures equal treatment within the classes of priorities.

based on knowledge of the reinsurance obtained by the insurer. The reinsurance agreement is one by which the assuming company indemnifies the ceding company for a portion of the paid loss. The reinsurer does not assume the ceding company's liability.

The law in the United States has traditionally held that persons not party to the reinsurance agreement have no privity to the reinsurer. Thus, it comes as a novel proposition that a primary insurer may, by reason of the reinsurance contract, be an agent of its reinsurers. The courts of the United States which have addressed the insurer-reinsurer relationship have generally refused to embrace such a legal conclusion.[107]

The rationale for finding no agency is as follows:

> If privity between the reinsurer and the insured, parties claiming directly against the reinsurer cannot be established, a principal/agent relationship between the reinsurer and the primary insurer or its employees also cannot be established.

The earliest of the federal appellate courts addressing this issue stated the plaintiff's claim as follows: "The grounds which the plaintiffs rest their rights to recover against the reinsurers are ... (i) that the reinsurers, through the surety company (the primary company) as their agent, entered into contractual relationships with the use-plaintiffs when it undertook... to pay for the labor and materials

107. See Aetna v. Glens Falls Ins. Co., 453 F. 2d 686 (5th Cir. 1972) A/S Ivarans Rederic v. Puerto Rico ports Auth., 617 F. 2d 946 (4th Cir. 1934) Employers Reins. Corp. v. Am. Fidelity and Casualty, 196 F. Supp. 553 (W.D. Mo. 1959)

supplied."[108] The court found, notwithstanding the direct payment of a claim by the reinsurer, no agency existed:

> It is true that the reinsurance agreements authorized the surety company to act for the reinsurers in all matters arising in connection with any claim, and to take any action in regard thereto which it might deem advisable; its decision or settlement to be final and conclusive and unconditionally binding upon the reinsurers. These provisions of the reinsurance agreements seem to have been designed with relation to the parties thereto, so that the liability of the reinsurers to the surety company would not be diminished or adversely affected by any arrangement in the nature of a settlement or compromise which the surety company might make with the claimants; and it does not appear from the facts alleged that the reinsuring companies became parties to any contract between the surety company and the materialmen for the completion of the work.[109]

Similarly, in the case of Aetna Insurance Co. v. Glens Falls Insurance Co., [110] the court stated the issue before the court to be as follows:" The appeal involves the existence of an agency relationship between two reinsurers and an employee of the reinsured." The employee in that case was an underwriter. The court's rejection of such a principal-agent relationship is as follows:

> The district court's analysis of the transaction portrayed Palmer (the insurer's employee) as wearing two hats at the same time.

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108. United States, to use of Colonial Brick Corp. v. Federal Sur. Co., 72 F. 2d 946 (4th Cir. 1934)
109. Id at 968
110. 453 F.2d 687 (5th Cir 1972)

i.e., as acting for the reinsured in ceding the reinsurance and at the same time acting for the reinsurers in accepting the reinsurance. This misconstrues the nature of the reinsured and the reinsurers. The reinsurance treaties, and not Palmer, bound the reinsurers.[111]

In Safeway Trails, Ins. v. Stuyvesant Ins. Co.,[112] the court expressly found that, despite representations by the primary company's agent regarding the reinsurance and the reliance upon those representations by the insured, the agents of the primary company "were not agents of the reinsurers and had no authority to speak for them.'

If no privity between the reinsurers and any party other than the original insurer existed as a matter of law, the cases conclude that no agency relationship could exist between the employees of the primary company and the reinsurers. There are three elements necessary to establish agency. The first is the authority of the reinsurer to control the actions and representations of the employees of the primary company. Under the normal operation of reinsurance agreements, the reinsurer could not dictate, deny, or control the claims practices of the primary company. By the terms of the contract, the reinsurer is bound economically for settlements made within the underlying policy and the coverage of the treaty.

The second element of agency is the power of the agent to alter legal relationships between the principal and third parties. The cases are overwhelmingly clear that no privity exists between the reinsurer

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111. Id. at 290
112. 211 F. Supp. 227, 233 (M.D.N.C. 1962)

and any third party and that the contract remains one purely of indemnity unless it expressly provides otherwise. In most reinsurance relationships the employees of the primary company have no power to unilaterally alter the legal relationship of the reinsurer to any party.

Lastly, the law of agency says that apparent authority is dependent upon a factual showing that the third party relied upon the misrepresentation of the alleged agent because of some misleading conduct on the part of the principal and not the agent. Where the record is devoid of any evidence that the reinsurers took any affirmative action which would have misled the third parties involved, no agency can be established. The apparent authority for which the principal may be held liable must be traceable to him; it cannot be established by the unauthorized acts, representations, or conduct of the agent.[113]

b. Unfair Claims Practices Act

In Royal Globe v. Superior Court of Butte County,[114] the court created a right of recovery for a third-party claimant against the insurer of the negligent party based solely on a state Unfair Claims Practices Act. The decision has been widely reported and insurers have become increasingly subjected to Royal Globe-type causes of action in California and many other states.

The California Supreme Court held in Royal Globe that a suit against a liability insurer could be maintained only after the cause action between the injured party and the insured was concluded. Then a cause in tort for violation of the Unfair Claims Practices Act

113. 2 N.Y. Jur. Agency 89 at 253.
114. 153 Cal. Rptr. 842, 592 P.2d 329 (1979)

was permissible and was not dependent on any express or implied contractual duty on the part of the insurer to settle with the insured or the claimant, i.e., no privity of contract between the claimant and the insurer was necessary.

The legal theory upon which a reinsurer's liability could exist under the Unfair Claims Practices Act is not apparent, since by the terms of most reinsurance agreements the primary insurer remains singularly responsible for claims matters. The argument for such liability is based on the assumption that the Act applies to trade practices of "insurers," which encompasses reinsurers, and "insurance" which includes reinsurance. Furthermore, the argument follows, the cause of action is based on a statutory duty not arising in contract and not excusable by contract. Thus, statutes and case law to the effect that the original insured has no interest in a contract of reinsurance are irrelevant for Royal Globe-type claims because these claimants are third parties, not insureds, and contractual interests are unnecessary predicates to enforce statutory duties.

The reinsurer's response to this demand is sound in law and reinsurance practice. To establish the tort the claimant must first establish the duty owed him. The Royal Globe decision did not establish new duties, it established a new right of enforcement. If, as is true under most reinsurance contracts, the reinsured remained singularly responsible for the defense and settlement of policyholder claims, the reinsurer had no right to direct claims or actively manipulate a claim decision. The reinsurer then would not come within the purview of the Act since the reinsurer was not in privity with any party other than the reinsured. No duty to the insured or claimant exists and Royal Globe creates no civil liability.[115]

c. Third-Party Beneficiary

In limited situations case law recognizes third-party beneficiary theories of recovery. The general rule holds that a contracting party, such as the insured, must have intended the third party to benefit from the contract at the time of formation.[116] The intent to benefit may be shown by express contract language covering the third party, or by a special relationship between the insured and third party, such as a familiar one, establishing an implied intent to benefit.[117] Whether express or implied, this intent to benefit must be clearly shown.

Insureds and claimants have contended that they should be able to recover directly from the reinsurer as the third-party beneficiaries of the reinsurance agreement. However, the reinsurance contract gives indemnity rights to the reinsured but not to an unintended third party beneficiary. Moreover, statutes deny privity between the insured and the reinsurer. This theory has been thus far ineffective . The courts have also ruled that the insureds and claimants are not third-party beneficiaries of the reinsurance relationship.[118]

2. Direct Actions by Guaranty Funds

A number of guaranty funds have attempted to collect reinsurance proceeds directly from reinsurers on the bases that the

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115. Franklin W. Nutter, Reinsurance Issues In The Liquidation of Insolvent Insurers, 18 Forum at 305

116. Murphy v. Allstate Insurance Co., 17 Cal. App. 3d 937

117. Johansen v. California State Auto Ass'n Inter-Insurance Bureau, 15 Cal. App. 3d 399 (1975)

118. United States v. Fed. Surety Company, 72 F.2d 964 (4th Cir. 1934) Am. Re-Ins. Co. v. Ins. Comm'r, 527 F. Supp. 444 (C.D. Cal. 1981)

guaranty fund is the statutory successor to the insolvent company or that they are the third-party beneficiaries of the reinsurance agreement. However, the courts have rejected such attempts.[119]

119. The domiciliary liquidator is the statutory successor to the insolvent insurance company. Skandia Am. Rein.s. Corp. v. Barnes, 458 F. Supp. 13 (D. Col. 1978)
The guaranty fund is not the third-party beneficiary of the reinsurance agreement. Gen. Reins. Corp. v. Mo. Gen., 458 F. Supp. 1(W.D. Mo.1977)

CHAPTER 3

Institutional Approaches to Insurer Insolvency and Reinsurer's Liability

The fundamental purpose of reinsurance is to spread the risk of loss. As explained by the Reinsurance Association of America:

> Reinsurance enhances the universal risks spreading objectives of insurance. Reinsurance is purchased by an insurer for one or more of the following reasons:
>
> 1. To reduce their net exposure to liability on particular risks....
> 2. To protect against accumulations of losses arising out of catastrophes....
> 3. To reduce total liabilities to a level appropriate to their premium volume and capital....
> 4. To reduce exposure to certain (possibly more hazardous) lines of business or to alter their "mix" of business....
> 5. To help stabilize overall operating results....
> 6. To obtain assistance with new concepts and lines of insurance....

However, the international insurance and reinsurance markets are in the grip of a recurrent insurance and reinsurance coverage and solvency crisis. It has been suggested that the current crisis is a painful but inevitable and necessary economic correction of the industry's recent mismanagement and bad judgment.[120] However, it is the issue of insurer and reinsurer insolvency- a painful byproduct of the crisis that makes the crisis a problem of subtle complexity and long-term concern.

Generally, when an insurer becomes insolvent, its assets must be liquidated in accordance with state statutes. In the usual proceeding, a state insurance administrator will apply to a state court for an order of liquidation. If the court orders liquidation, it will have exclusive jurisdiction of any claims made against the insolvent insurer. The administrator then liquidates the insurer for the benefit of all its creditors, including its reinsurers, subject to their proofs of claims. Clearly, it behooves reinsurers to closely monitor ceding companies in regard to solvency.

The recent economic turmoil in the international insurance and reinsurance markets has forced to the surface legal issues and ambiguities that are increasingly exploited by market participants in order to deny or avoid payment. It has been reported that 79 American companies were placed in involuntary rehabilitation between 1984 and 1986 and that 811 companies were on the national Association of Insurance Commissioners' list "for regulatory attention." However, the insurance trade press is filled with dire analyses of perceived inadequacies in the state insurance regulatory system in the United States. Some analysts have estimated that 10 percent to 20 percent of the $70 billion of reinsurance that should be recoverable will not be collected. The increasing rate of insolvencies and a

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120. Teff, Alarm from London, Brief, Fall 1985, at 17

domino effect of ineffective rehabilitations and liquidations could block increasing amounts of the cash flow in the insurance and reinsurance market. This would increase the actual size of the reinsurance collections problems.

Although the relationship between the parties to a reinsurance contract is an exercise of fiduciary responsibility to each other, disputes arise as in any commercial endeavor. However, the parties to reinsurance contracts have resorted first to negotiation as the optimum solution. Where that fails contracts commonly require the parties to arbitrate their differences. Arbitration is viewed as no substitute for negotiation but instead as a means to preserve the relationship without sacrificing a company's ability to resolve a matter of fundamental principle. Where all else fails, the parties to a reinsurance contract may litigate. Most of the litigation that has risen has been between reinsurers and persons not party to the agreement. Perhaps most notable is litigation prompted by the insolvency of a party to the reinsurance agreement. From the foregoing, it is clear that the reinsurance industry is in need of aid to fight against the obstacles it faces in overcoming the effects of reinsurance crises.

A review of litigation stemming from the insolvency of insurers reveals that several very basic reinsurance-related issues are well settled. Principal among them is that reinsurance is an idemnity relationship in which persons not party to the reinsurance agreement have no interest and or privy. The insolvency of the reinsured does not affect this fundamental premise.

The best protection for reinsurers from the dangers of insurer insolvency has come through governmental regulations. However, as one commentator said, reinsurance and insolvency law and practice in our intertwined jurisdictions lack and must develop a soundly reasoned and compatible framework, which enforce the morality of utmost good faith, if we are to prevent economic and legal chaos in the international insurance and reinsurance markets and the balkanized courts.[121]

A. Arbitration

Virtually all reinsurance agreements will involve interstate commerce and thereby fall under the Federal Arbitration Act ("the Act").[122] The Act provides that written provisions for arbitration of future disputes in commercial or maritime transactions are valid, irrevocable, and enforceable.[123] The principal objective of the statute is to enforce private agreements to arbitrate. While arbitrability of disputes involving domestic transactions is governed by Chapter 1 of the Act, arbitration in international transactions is governed by the Convention on Recognition and Enforcement of Foreign Arbitral Awards as implemented by Chapter 2 of the Federal Arbitration Act.[124] Further, an action or proceeding falling under the Convention is deemed to arise under the laws and treaties of the United States and the district courts of the United States are deemed to have original jurisdiction over such proceedings without regard to the amount in controversy.

121. John Milligan-Wbyte and Mary Cannon Veed, Bermudian, English And American Reinsurance Arbitration Law And Practice And Alternative Dispute Resolution Methods, 25 Tort & Insurance Law Journal at 122.

122. 9 U.S.C. 2

123. 9 U.S.C. 201-207 (1986)

124. Id.

The Act requires a federal court, when faced with an action to stay litigation pending arbitration or compel arbitration, to make only three determinations. The first step is the jurisdictional inquiry whether the subject matter of arbitration involves either a maritime transaction or a transaction in interstate commerce. If either of these alternative requirements is present, the court must then determine whether a valid agreement to arbitrate exists. If a valid agreement is found, the court must finally determine whether the particular dispute is arbitrable, i.e., whether the parties intended the disputes be arbitrated. Hence, while the court may examine issues concerning the making and performance of the arbitration agreement, it may not analyze the merits of the underlying dispute.[125] Although the scope of judicial involvement in the arbitral process has been narrowly circumscribed, the Act has left unaddressed the means or standards by which a court may determine whether a dispute is arbitrable or whether an agreement to arbitrate exists at all. These questions are vital simply because under an arbitration agreement, a party cannot be compelled to arbitrate if it did not agree to do so.

Determination of the parties' intent is not problematic when the parties have narrowly limited the disputes they are willing to arbitrate to one or only a few very specific items. However, it is more often the case that parties cannot foretell what the future may bring and therefore attempt to design a more general arbitration clause, capable of covering foreseeable as well as unforeseeable events. Determining intention therefore becomes a distinct and different exercise

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125. Berstein v. Centaur Insurance Company, 644 F. Supp. 1341 (S.D.N.Y. 1986)

depending upon whether the parties have chosen an itemized, narrow or broadly sculpted arbitration clause.

Disputes regarding reinsurance have often been resolved through arbitration guided by arbitration clauses that normally provide as follows:

> Any unresolved difference opinion between the Reinsurer and the Company with respect to the interpretation of this certificate or the performance of the obligations under this certificate shall be submitted to arbitration. Each party shall select an arbitrator within one month after written request for arbitration has been received from the party requesting arbitration. These two arbitrators shall select a third arbitrator within ten days after both have been appointed. Should the arbitrators fail to agree on a third arbitrator, each arbitrator shall select one name from a list of three names submitted by the other arbitrator, and the third arbitrator shall be selected by lot between the two names chosen. The arbitrators shall be impartial and shall be present or former officials of other property or casualty insurance or reinsurance companies. The arbitrators shall adopt their own rules and procedures, and shall render their decision with a view to effecting the intent of this certificate. The decision of the majority of arbitrators shall be final and binding on the parties. The cost of arbitration, including the fees of the arbitrator, shall be shared equally unless the arbitrators decide otherwise.

In addition, the arbitration clauses normally provide for the location of the arbitration, the method of selection of arbitrators, the law which will apply and the procedures to be used.[126] The popularity of arbitration is not based on its speed or economy but upon the hope of the parties to the contract that they can maintain a degree of control over the intensity of the dispute and the methods used to resolve it, which they perceive to be impossible in the lawyer-dominated field of litigation. Consequently, arbitration is perhaps best resorted to under four circumstances.

First, it is frequently employed in connection with routine business under which the parties expect to have disputes that will not interfere with the business relationship between them. In those circumstances, arbitration sometimes can be carried out in an atmosphere of civility that does not destroy an ongoing business relationship. Because of the nature of the relationship that already exists, they are unlikely to need the more extensive discovery of witnesses and documents that may be available in litigation. Perhaps most important, success of either party in this type of relatively minor dispute is not determinative of the survival of the loser. It is entirely possible that arbitration will produce a bad result. However, if the dispute is such that the parties can more easily afford error than stalemate, arbitration is a very logical choice.

A second type of case that lends itself well to arbitration is a dispute in which the decision-maker will need a generally international viewpoint in order to fairly decide the merit of an

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126. Donald W. Rees. And Carol E. Reese, Reinsurance: The Basic and Bad Faith Considerations, 39 Fed'n Ins & Corp Coun Q. at 361

argument. Parties who feel they have a cosmopolitan relationship requiring such an international view may also conclude that a neutral forum, in which neither party has an undue advantage, is the fairest sites for the resolution of any dispute.

A third type of situation that may benefit from a neutral territory arbitration clause is one for which the choice of a particular system of law is very important. It may be possible, by use of an arbitration clause that directs that arbitration awards not be subject to appeal, to avoid expensive interpretations of law that might frustrate the purpose of the contract.

The availability of the New York Convention for enforcement of awards is a final good reason to arbitrate. Even if one obtains jurisdiction over a foreign party in a friendly forum, recognition and enforcement of court judgements in other countries where the opponent may have assets requires considerable ingenuity as well as patience. There is no uniform or widely accepted mechanism for enforcing judgments, and error is easy to commit. Among the jurisdictions which have acceded to it, the New York Convention gives arbitral awards much enhanced authority and enforceability. Collection may be greatly facilitated by the flexibility to pursue a defendant wherever he may have assets.[127]

In the recent climate of insurance insolvencies, one particular issue that has received judicial attention is whether a liquidator is bound by the insolvent company's agreement to arbitrate. Liquidators

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127. John Milligan-Wbyte and Mary Cannon Veed, Bermudian, English And American Reinsurance Arbitration Law And Practice And Alternative Dispute Resolution Methods, 25 Tort & Insurance Law Journal at 148-149

typically shun arbitration and prefer to resolve reinsurance disputes in the state liquidation court.[128]

In Matter of Knickerbocker Agency v. Holz, the New York Court of Appeals concluded that a liquidator was not compelled to arbitrate, because the liquidation order vested exclusive jurisdiction over all claims involving the insolvent company in the New York State Supreme Court. The parties demanding arbitration were New York State residents, and the insolvent company was organized under the laws of the State of New York. Thus, it appears that Knickerbocker did not concern a transaction falling under the Federal Arbitration Act.

In Bernstein v. Centaur Insurance Company,[129] the court relied upon existing authority, Hamilton Life Ins. Co. N.Y. v. Republic National Life, to enforce an arbitration agreement against a liquidator.[130] The Hamliton Life court compelled arbitration in a reinsurance dispute where the reinsurer opposed arbitration on the ground that application of the Federal Arbitration Act was precluded by the McCarran-Ferguson Act. The court held that the Federal Arbitration Act did not "invalidate, impair or supercede any law enacted by any State for the purpose of regulating insurance." Rather the Federal Arbitration Act regulated a method of handling disputes generally.[131] The plaintiff was under the supervision of the New York State Insurance Department.

In Bernstein, the reinsurer moved under 9 U.S.C. 3 to stay an action initially commenced in federal district court by two ceding

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128. Matter of knickerbocker Agency v. Holz, 4 N.Y. 2d 245 (1948)
129. 606 F. Supp. 98 (S.D.N.Y. 1984)
130. 408 F.2d 606 (2d Cir 1969)
131. 408 F. 2d at 611; see 15 U.S.C. 1011 (1945)

companies on several facultative reinsurance certificates, all of which contained arbitration clauses. Both reinsureds were then placed into liquidation and the respective New York and Vermont liquidators were substituted as plaintiffs. The liquidators opposed the reinsurer's motion on the ground that the McCarran-Ferguson Act precluded federal interference with state insurance liquidation proceedings. The federal district court rejected this contention and granted the stay motion, adhering to the reasoning of Hamilton Life and also distinguishing Knickerbocker on the ground that the insolvent company and the liquidators were plaintiffs.[132] Moreover, unlike Knickerbocker, the reinsured was a non-resident. The court rejected the notion that arbitration proceedings would interfere with state liquidation proceedings.[133]

The conflict between state liquidation proceedings and the Federal Arbitration Act arose in a different procedural posture in Universal Marine Insurance Company v. Beacon Insurance Company.[134] Following the court's order compelling arbitration at the request of one defendant, Cherokee Insurance Company, was placed into receivership pursuant to the Tennessee rehabilitation statute. Cherokee then moved to stay the action and arbitration on the ground that the McCarran-Ferguson Act, Uniform insurers Liquidation Act and the doctrine of abstention mandated that the court abstain from the exercise of jurisdiction under the Federal Arbitration Act. The court found that the claims under the Federal Arbitration Act were

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132. 606 F. Supp. at 102-103
133. Id
134. No. ST-C-83-328, slip op.at4-7 (W.D.N.C. 1984)

significant and the right to arbitrate under the Federal Arbitration Act was not likely to be given affect in state rehabilitation court.[135] The court observed that the Uniform Insurers Liquidation Act does not require an exclusive state proceeding and there could be numerous fragmented proceedings in various states.[136] The court therefore ordered that the arbitration should proceed and that the non-arbitral claims should be tried in the federal court. The court noted that the parties would be required to satisfy any judgment in the rehabilitation proceedings.

Another New York federal district court, however, reverted to the Knickerbocker analysis. In Wasbburn v. Corcoran,[137] which was an action to compel arbitration under 9 U.S.C. 4, Judge Leval concluded that enforcement of the Federal Arbitration Act against a liquidator would interfere with state regulation of insurance in violation of the McCarran-Forguson Act.[138] The Wasbburn court reasoned that "as the highest court of New York has ruled that arbitration is incompatible with the commands of Article 74, it necessarily follows that enforcement of a federal statute requiring would defeat this provision of the state statute."[139] Wasbburn appears to be the only decision where a plaintiff moved to compel arbitration against a liquidator. Interestingly, the plaintiff himself was a liquidator; Wasbburn involved a dispute between the Illinois liquidator of Optimum Insurance

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135. Id.
136. Id.
137. 643 F. Supp. 554 (S.D.N.Y. 1986)
138. Id. at 556.
139. Id. at 557

Company and the New York liquidator of its corporate parent, Ideal Mutual Insurance Company.

The Wasbburn court seems to have ignored the fact that Knickerbocker did not involve the Federal Arbitration Act, but rather a dispute between New York residents falling under the New York arbitration statute. Wasbburn makes no reference to Hamilton Life which concluded that the Federal Arbitration Act did not impact upon state regulation of insurance. It is submitted that the Bernstein court reached the correct result. As the court in Universal Marine recognized, arbitration of claims involving insolvent insurers or reinsurers would not interfere with the operation of state statutory liquidation procedures. An arbitration award cannot be immediately executed upon and must be confirmed by a court having jurisdiction.

Absention might be proper if the award were brought to a federal district court for confirmation. In the case of an award against an insolvent company, the award would appropriately be presented to the liquidation court for confirmation. At that time, the liquidation court would be in a position to address any concerns under state liquidation statutes.

In sum, the courts have devised solutions to conflicts between arbitration and litigation, but their decisions are inconsistent. Except for liquidation, the safest route to an efficient arbitration is to draft an arbitration clause that anticipates potential disputes involving multiple parties.

B. Disadvantages In Reinsurance Arbitration

1. Multiple Parties and Multiple Claims

Reinsurance controversies frequently involve multiple parties and a sequence of separate transactions. There is a possibility in an international controversy, not just that one's position might not be sustained, but that he may suffer inconsistent determinations in different jurisdictions. These inconsistencies can be avoided to the degree one can arrange to have all of the parties to the controversy brought into a single forum. United States procedural law, although it varies from jurisdiction to jurisdiction, generally provides fairly useful and flexible mechanisms for consolidating separate litigations that have a common factual nucleus, and coordinating the timing of litigation so decisions can be made, if not in the same forum, at least in logical order.[140]

In the reinsurance industry, arbitration clauses are the rule rather than the exception, but it is not so common to find arbitration agreements with a reinsurance intermediary or general agent, both of whom may be appropriate and necessary parties to a reinsurance dispute. If litigation is commenced to join non-arbitrating parties, the parties to an arbitration agreement may choose to abandon arbitration and litigate their disputes. However, if one of the parties insists on its contractual right to arbitrate, litigation may be commenced by or against the intermediary, general agent or another party involved in the dispute. An arbitration clause may provide that an intermediary, broker or agent, will consent to be joined in any arbitration between

140. See The United States Federal Court Manual For Complex Litigation

the principals. Such a provision can be incorporated into the standard "intermediary clause." However, the rule of the intermediary in the selection of arbitrators will present a problem. An intermediary or agent is unlikely to look favorably upon arbitration when it is without a voice on the arbitration panel.

When faced with multiparty disputes where not all the participants can be compelled to arbitrate, courts have stayed litigation and allowed arbitration to proceed where the issues are similar and the arbitration is likely to determine the issues in the litigation. Federal courts in the Second Circuit have developed the following criteria required for a determination that a stay should be granted:

1. the moving party has not and will not impede the progress of the arbitration proceeding;

2. the arbitration can be expected to conclude within a reasonable time; and

3. such delay as may occur will not work undue hardship. the courts will generally limit the length of the stay or otherwise impose conditions on granting the relief.[141]

The same practical effect can sometimes be achieved in the discretion of the trial court by the granting of a stay of litigation pending the outcome of the arbitration. This is supported by the court's inherent power to control its docket to prevent the expenditure of effort on duplicative proceedings. Arbitration proceedings cannot usually be stayed pending litigation, but there is

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141. John M. Nonna and Jonathan E. Strassberg, reinsurance Arbitration: Boon or Bust? 22 Tort & Insurance Journal 198 at 597

no such restriction on stays of litigation. The non-contracting parties may have a strong incentive to join the arbitration if they are invited, and to include in it issues which might otherwise be litigated, so as to avoid any prejudice arising from an arbitral decision taken in their absence.

2. Consolidation

Another problem in which arbitration may result in dispute resolution occurs where the disputants are parties to arbitration clauses in separate reinsurance agreements, for example, disputes between a reinsured and several of its reinsurers or even disputes between parties with several agreements between them. In Universal Marine Insurance Company Ltd. v. Beacon Insurance Company,[142] the court attempted to encourage resolution of the dilemma created by five separate arbitration agreements involving three parties, by staying its order compelling arbitration to allow the parties"to reform the five separate arbitration clauses in order to develop a unified arbitrable process."[143]

Consolidation does not resolve the problem of arbitrator selection under the typical methods provided in reinsurance agreements. If each arbitration clause confers a right on each reinsurer to select an arbitrator, then consolidation in a dispute involving numerous reinsurers could result in as many arbitrators as lawyers, most of whom would be appointed by reinsurers. Reinsurance agreements have provided that all reinsurers shall be treated as one

142. 588 F. Supp. 735 (W.d.N.C. 1984)
143. 588 F. Supp. 739

for the purpose of selection of arbitrators. Another alternative is available in institutional arbitration where an independent organization such as the American Arbitration Association can be authorized to choose the arbitrators from a qualified list of candidates.[144]

Courts have been inconsistent in granting consolidation, in the absence of a specific agreement to consolidate. In Compagnia Espanola de Petroleas, S.A., v. Nereus Sbipping, S.A.,[145] the Second Circuit Court of Appeals held that district courts have the inherent power to consolidate arbitration of claims involving common questions of law and fact. However, recently in Weyerbauser v. Western Seas Sbipping Co.,[146] the Ninth Circuit Court of Appeals held that two arbitrations could not be consolidated in the absence of a written agreement providing for consolidated arbitration.[147] In Ore & Chemical Corp. v. Stinnes Interoil Inc.,[148] the court maintained that "when the parties themselves have not placed a provision for consolidated arbitration in their arbitration agreement, 9 U.S.C. 4 does not provide any authority for a court order compelling consolidated arbitration."[149] In Sociedad Anonima de Navegacion Petrolea v. Cia de Petroleas De Cblie S.A.,[150] the Supreme Court implicitly rejected consolidation absent agreement. In light of the unsettled law in this area, it is advisable that if the parties do wish to consolidate

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144. American Arbitration Association, Commercial Arbitration Rules of The American Arbitration Association, 13 .
145. 527 F. 2d 966 (2d Cir. 1975)
146. 743 F. 2d 635 (9th Cir. 1984)
147. 743 F.2d at 637
148. 606 F. Supp. 1510 (S. D. N.Y. 1985)
149. 606 F. Supp. at 1510
150. 634 F. Supp.805(S.D.N.Y.1986)

arbitrations among various reinsurers, or arbitrations with a reinsurer and an intermediary or agent, a specific provision for consolidation be inserted in the arbitration clause.

3. Discovery

It is sometimes argued that the limited degree of "discovery" available in an arbitration proceeding is one of its chief virtues, since it permits much less expensive proceedings. It is true to say that one of the chief virtues of arbitration is the ability of the arbitral panel in all jurisdictions to control the collection of evidence for use at the arbitral hearing in a manner that respects the balance between cost and effectiveness.

In the first instance, most of the evidence relevant to a proceeding will often be in the hands, or at least within the reach, of only one of the parties. Under American Law, the arbitrators, upon request and within their discretion, may order the production of documents or persons within the reach of a party, and may enforce their order by the indirect, but by no means ineffective mechanism of drawing negative inferences from the failure of any party to produce records or witnesses as ordered.

Accessibility of non-party witnesses is a more difficult problem. The Federal Arbitration Act provides that a panel of arbitrators may take advantage of the subpoena power of the federal court in the jurisdiction in which it is sitting, and on petition to the federal court, have any contempt for such subpoenas punished.[151] It is clear,

151. 9 U.S.C. 7

however, in American law, that automatic recourse to Federal Rules of Civil Procedure discovery mechanisms is not available in an arbitration simply at the behest of the parties. The entire scope of discovery is subject to the control of the arbitrators and vests only secondarily in the courts. On the other hand, American courts will not automatically accede to the arbitrators' request for assistance, and may demand a showing of necessity or special circumstance.[152]

C. Alternate Methods of Dispute Resolution

1. Settlement

Any dispute can be settled, at any time. A settlement can occur within minutes of the development of a controversy or at its bitter end. In a complex matter, the parties will struggle to develop a clear understanding of exactly what their agreement entails and what contractual and tort liability exists.

A commutation is a specialized form of settlement of an insurance or reinsurance contract. A commutation provides for estimation, payment and complete discharge of all or particular obligations between the parties for reinsurance losses.[153] From the perspective of an assuming company, the advantages of a commutation may include:

a. removing the future uncertainty regarding the ultimate losses under the treaty,

b. eliminating future administration costs,

152. Oceanic Transport corp. of Monoria et al. v. Akoa Steamship Co. , 129 F. Supp. 160 (S.D.N.Y. 1954)

153. E. Wollen & F. Pomeranty, Commutation of Losses in Reinsurance, Law& Prac. Int'l Reinsur. Collections & Insolvency 143 (D. Spector & J. Milligan-Whyte, eds., 1988)

c. utilizing available tax credits,

d. using the surplus/earnings relief obtained by commuting at the discounted value,

e. providing additional capacity to write new business, and

f. recognizing reserve problems at minimum capital cost.

From the perspective of a cedant, the advantages of a commutation may include:

a. obtaining immediate payment of long term obligations,

b. avoiding future oversight of an embarrassing book of business or escaping a potential dispute,

c. eliminating costs associated with reporting to numerous small reinsurers, and

d. solving collection problems.

The preparation for commutation involves consideration of:

a. the ultimate amount of premiums and losses under the treaty,

b. the cash flow underlying the ultimate losses and ultimate premiums,

c. the present(i.e., discounted) value of the loss cash flow net of future premiums, and

d. the uncertainty involved in the estimates provided.

A valid commutation can be a very useful and relatively inexpensive way to quantify and minimize loss exposures or obtain a refund of cash and a release from a reinsurance contract. A commutation also can rapidly and cleanly settle a bad relationship before it gets worse, as well as extricate an entity from a commitment which has proven unsatisfactory without unnecessary damage to the business relationship with the other party.

Drafting a commutation agreement requires close collaboration between management and counsel. Companies commuting reinsurance agreements should be extremely careful to obtain expert legal advice in all relevant jurisdictions before consummating the commutation particularly with companies in strained circumstances.[154]

2. Conciliation

Both the American Arbitration Association and the International Chamber of Commerce maintain conciliation procedures, which may be elected by the parties either in their contract or after a dispute has arisen. However, the conciliator is commonly disqualified from acting as an arbitrator in a later arbitration.

3. Arbitration or Litigation?

It is impossible to categorically recommend litigation or arbitration as the best procedure for effectively resolving reinsurance disputes. Arbitration has sometimes been perceived as the solution to every inconvenience attendant to the judicial system. Because one has to pay for the services of arbitrators and the space in which to conduct the hearing, arbitration is not necessarily cheaper than comparable litigation. Nor is it always quicker. In general, the delays attendant on both litigation and arbitration arise primarily from the needs of the

154. John Milligan-Whyte and Mary Cannon Veed, Bermudian, English And American Reinsurance Arbitration Law And Practice and alternative Dispute Resolution Methods, 25 Tort & Ins Law Journal.

parties and their lawyers, rather than the inertia inherent in the court or arbitral systems.

Litigation has the advantages of being determined by judges who are usually familiar with basic principles of law, at least within the jurisdiction where a judgment is rendered. However, this is not as great an advantage in the international context as it is in the domestic one, due to the hazards of foreign enforcement of judgements. However, the choice between arbitration or litigation depends on the nature of the dispute, its degree of complexity and the prospects of enforcement of an arbitration award or judgment in other jurisdictions.

CONCLUSION

Reinsurance agreements are made for the mutual benefit of the two companies and are considered contracts of utmost good faith. Utmost good faith is vital in any reinsurance relationship. The reinsurance contract notwithstanding, the relationship is an exercise of fiduciary responsibility to each other. An individual policyholder has no direct contractual interest in the relationship. There is no privity of contract between the insured and the reinsurer, and thus a policyholder has no right to enforce the contract or collect directly from the reinsurer. However, under special circumstances a reinsurer may provide a cut-through endorsement for first-party insurance wherein the original policy is amended in such a fashion that the insured has the added protection of having the reinsurer pay a loss directly in the event the insurance company issuing the policy cannot pay. The net effect of a cut-through endorsement is only to revise the route of payment and there is no increased risk to the reinsurer.[154]

The foregoing discussion demonstrates that much of the reinsurer's concern focuses on extra-contractual damages. There are two bases upon which a ceding insurer might ask its reinsurer to assist it with punitive damages. One is when the damages are assessed against the insured and the insurer is held liable because of its

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154. Thompson, Critical Issues of the Eighties: How Trends in Reinsurance Will Affect Legal, Legislative, and Regulatory Actions, 16 Forum 1038 (1981) at 1043

contractual relationship with the insured. In this case, usually referred to as an "excess policy limits judgment" the reinsurer shares the cost because the obligation arises from the contractual obligation of the insurer, a share of which has been ceded to the reinsurer. The other basis for liability is the independent tort of the insurer committed against its own insured. This typically arises in the handling of claims. Reinsurers generally take the position that since they do not control the claim-handling process of the insurer, they should not be liable for a tortious act committed by persons over whom they have no control or supervision. The insurer may argue that the reinsurer should share in payment of extra-contractual damages because this is an exposure which is a fact of life in the marketplace today. They believe they should not be left to pay the costs which arise from activities which are intended to be for the joint benefit of the insurer and reinsurer, costs which may arise from practices which are normal and usual in the insurance industry today. On the other hand, the reinsurer believes, on the basis of its contract, that it is entitled to expect that the insurer will fulfill in good faith its obligation to conduct its business in ways which are beneficial to both parties to the reinsurance contract. The reinsurer may also believe that there is a legal impediment to its contribution to payment of extra-contractual damages. Such payment would be in the nature of errors and omissions coverage, provided without a filed contract, approved rates or payment of premium taxes.[155]

155. Id. at 1051

Extracontractual damages are in the nature of a peak exposure,[156] if reinsurers are to pay them, certainly they should receive some consideration from ceding companies. If reinsurers are not compensated for their largess, then it is understandable that they are now shying away from many types of coverage.

Of course, much of the difficulty in this area can be attribu*ed to reinsurance contract draftsmanship. Reinsurance contracts are generally construed as covering contractual obligations only, if the primary insurance contract does not cover punitive damages, then a reinsurer will not be liable to a reinsured who pays punitive damages on behalf of its insured. Thus, it is critically important that reinsurers draft agreements with the utmost care, so as to preclude reinsurer liability for damages they might ordinarily and reasonably regard as "extra-contractual."[157] A reinsurer may also be able to avoid contributing to punitive damage awards imposed upon the reinsured by asserting the existence of public policy which prohibits the insurability of punitive damages.

Reinsurance is a highly international business. There is not enough capital or capacity in any one country to let the theory of the law of large numbers operate effectively without utilizing the world reinsurance markets. Reinsurers traditionally think in terms of balancing the exposures of one society against the perils present in another. When one deals with immense exposures, one must use the

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156. Id.

157. Bart c. Sullivan, Reinsurance in the Age of Crisis, 38 Fed'n Ins & Corp C.Q. (1987) at 13

entire world landscape.[158] Therefore, the reinsurance business is subject to economic and political disruption. Moreover, inflation may have an effect far larger than people think and may well be attended by other manifestations of economic crisis, such as sharp declines in the securities market.

The effects of inflation are far more serious for reinsurers than for insurers. For example, assume that reinsurers hold every dollar of reserves in casualty lines for an average of five years. Primary insurers hold reserves about half as long. This is to be expected as reinsurers handle the peak exposures and big cases take longer to settle than small ones. Therefore. inflation has twice as long to operate against a reinsurer's loss as it does against those of a ceding company.[159]

Many of these economic perils indirectly cause even more problems when they accelerate insurer insolvency and cause insurer assets to be liquidated in accordance with state statutes. If the court orders liquidation, it will have exclusive jurisdiction of any claims made against the insolvent insurer. Then the state administrator liquidates the insurer for the benefit of all its creditors, including its reinsurers. Therefore, it behooves reinsurers to closely monitor ceding companies in regard to solvency. The reasons are numerous and interrelated. In a general sense, insurer insolvency will concern reinsurers in times of severe or unusual market pressures, and during extended negative underwriting cycles.[160]

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158. Thompson, Critical Issues of the Eighties: How Trends in Reinsurance Will Affect Legal, Legislative, and Regulatory actions, 16 Forum 1038 (1981) at 1045
159. Id. at 1047
160. Nutter, The Reinsurance Resolution: The Reinsurer is Now Looking Over Your Shoulder, 34 FIC Q. 147, 151 (1984)

The best protection for reinsurers from the dangers of insurer insolvency has come through governmental regulation. The role of the federal government in insurance has grown gradually since the 1930s. The 1980s may see the entry of the federal government into reinsurance as well. In the past, the federal government stepped in to provide insurance for risks generally viewed as uninsurable. One method for doing this was to create federally chartered corporate entities, such as the Federal Deposit Insurance Corporation and the Securities Investors Protection Corporation. Still another approach is represented by the federal riot reinsurance program, Urban Property Protection and Riot Reinsurance Act of 1968, in which the government serves as a reinsurer but significant portions of the risk are retained by private insurers.[161]

Another federal development, coming from a different direction, is the McCarran-Ferguson Act. The purpose of the McCarran-Fetrguson Act was to exempt state insurance regulation from the federal antitrust laws- the Sherman, Clayton and Federal Trade Commission Acts. The McCarran-Ferguson Act generally provides that federal acts would not supersede state insurance regulation unless specifically provided, but that the antitrust laws would "be applicable to the business of insurance to the extent that such business is not regulated by State law.[162] However, this special relationship has been recently challenged by the Metzenbaum bill. This bill purports to leave the regulation of insurance in the hands of the state regulatory

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161. Thompson, Critical Issues of the Eighties: How Trends in Reinsurance Will Affect Legal, Legislative, and Regulatory Actions, 16 Forum 1038 (1981) at 1045
162. Id. at 1055

authorities, but makes their regulation subject to minimum federal standards. It also makes the federal antitrust laws applicable to insurance.[163]

163. Id.

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