Assaulting the Bellefonte Citadel

Reinsurers Win…Not So Fast

In the 1990 landmark decision of Bellefonte Reinsurance Co. v. Aetna Cas. & Sur. Co., 903 F.2d 910 (2d Cir. 1990), the Second Circuit Court of Appeals held that the reinsurer's liability was capped at the dollar amount stated in the "Reinsurance Accepted" provision of the applicable facultative certificate.

In doing so, the court relied on the portion of the applicable certificate which provided that Bellefonte agreed to reinsure Aetna "*subject to the … amount of liability set forth herein*."[1] *Id.* at 914. According to the Court of Appeals, as a matter of law, all costs and expenses incurred by Aetna were "subject to" the "amount of liability" (*i.e.*, the "Reinsurance Accepted"). *Id.* Although the applicable certificate provided for the payment of expenses "in addition" to the reinsurer's "proportion of settlements," the Court of Appeals held that any construction of the certificates that contemplated payment of an amount in excess of the dollar amount set forth as the "Reinsurance Accepted" "would negate" the "subject to" phrase. For the next two and half decades, all appellate courts and most trial courts considering the "Bellefonte" defense – some under different contract language – reached the same result as in *Bellefonte*.[2]

Two recent decisions have bucked that trend. *See Utica Mut. Ins. Co. v. Munich Reinsurance Am., Inc.*, 594 Fed. Appx. 700 (2d Cir. 2014) ("*Munich Re*"); *Century Indem. Co. v. OneBeacon Ins. Co.*, No. 02928 (Mar. 27, 2015 Ct. of Common Pleas, Phila. Cnty.) ("*OneBeacon*"). Those courts declined to reflexively follow the *Bellefonte* line of cases, and instead engaged in a more focused and nuanced analysis and interpretation of both the language and structure of the certificates before them.

In *Munich Re*, the Second Circuit Court of Appeals – the same court that issued the *Bellefonte* decision – reversed a district court order granting summary judgment to the reinsurer, holding that the trial court misapplied *Bellefonte* (and its progeny). In doing so, the Second Circuit underscored the critical importance of contract language, stating that "in the reinsurance context as in any other, a party is bound by the terms to which it has agreed." 594 Fed. Appx. at 704. Unlike the certificate at issue in *Bellefonte* (and other cases), Munich's certificate provided for indemnification "against *losses or damages* which the Company is legally obligated to pay under the policy reinsured…*subject to the reinsurance limits shown in the Declarations*." *Id.* at 703 (emphasis added).

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Rather than reflexively embracing *Bellefonte*, however, the Second Circuit held that "the Certificate's statement that 'losses or damages' are 'subject to' the limit of liability reasonably implies that expenses are not." *Id.* at 704. While this "negative implication" was "not strong enough… to demonstrate that expenses are unambiguously excluded from the limit of liability," the Court concluded that "it is sufficient to render the Certificate ambiguous." Accordingly, the Court remanded the case to the district court for "consideration of extrinsic evidence." *Id.*

Similarly, in *OneBeacon*, a Pennsylvania trial court just last month denied a reinsurer's motion for summary judgment on the *Bellefonte* issue. Picking up on the Second Circuit's "recent[] clarif[ication] that *Bellefonte* did not establish a blanket rule that all limits of liability are presumptively expense-inclusive," the court found that the certificate at issue, "while similar to *Bellefonte*, contains slight variations which leads to a different conclusion," and "cannot be ignored." *OneBeacon*, No. 02928 at 5-6. Specifically, unlike the certificates at issue in *Bellefonte* (which, as indicated above, provided that the reinsurer agreed to reinsure Aetna "*subject to the … amount of liability set forth herein*"), the certificates at issue in *OneBeacon* provided that OneBeacon reinsured Century/PEIC "subject to the general conditions set forth on the reverse side hereof." *Id.* at 2. One of those general conditions, like the certificate at issue in *Bellefonte*, provided for the reinsurer's payment of expenses "in addition" to its "loss payment[s]." According to the court, the difference in certificate language warranted a different conclusion than that reached by the court in *Bellefonte*:

> Instead of the terms being subject to the liability as in *Bellefonte*, the liability is subject to the terms and conditions. This places greater emphasis on the conditions themselves…As a result, a condition that excludes expenses in calculating the total loss limit holds more weight than the amount of 'Reinsurance Accepted' when interpreting these certificates.

Id. at 6.

Noting that "*Bellefonte* highlighted the importance of the 'subject to' language, and *Utica* demonstrated the ability of a court to reach a different interpretation" than was reached in *Bellefonte*, the Pennsylvania trial court concluded that "[i]f anything, the terms of the certificates may have created a presumption of expense-*exclusiveness*." *Id.* (emphasis in original).

Moreover, the court noted that even if it had "interpreted the certificate as being analogous to *Bellefonte*, the court would still have denied defendant's motion on the grounds that a latent ambiguity exists." *Id.* The court explained that, under

Pennsylvania law, "custom in the industry or usage in the trade is always relevant and admissible in construing commercial contracts and does not depend on any obvious ambiguity in the words of the contract." *Id.* at 7. According to the court, "[t]he application of industry custom and usage influences the meaning of the certificates, and highlights the existence of genuine issues of material fact which are to be determined by the finder of fact." *Id.*

In sum, two courts recently refused to rule in favor of either the reinsurer or the cedent as a matter of law on the "Bellefonte" issue. These cases reflect the courts' recognition that language matters, that a proper interpretation of facultative certificates requires a careful analysis of contract language and structure, and that even "slight variations" in certificate language can lead to "different conclusions." ●

Endnotes

1 Three years prior to *Bellefonte* a North Carolina federal court in *Penn Re, Inc. v. Aetna Cas. & Sur. Co.*, No. 85-385-CIV-5, 1987 WL 909519, at **5-10 (E.D.N.C. June 30, 1987) held that the applicable certificate unambiguously obligated the reinsurer to pay expenses in addition to the dollar amount set forth as the "Reinsurance Accepted."

2 *See, e.g.*, *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 4 F.3d 1049, 1068-69 (2d Cir. 1993); *Excess Ins. Co. v. Factory Mut. Ins.*, 3 N.Y.3d 577 (2004); *Pacific Employers Ins. Co. v. Global Reinsurance Corp.*, No. Civ. A. 09-6055, 2010 WL 1659760 (E.D. Pa. Apr. 23, 2010); *Global Reinsurance Corp. v. Century Indem. Co.*, No. 13 CIV. 06577, 2014 WL 4054260 (S.D.N.Y. Aug. 15, 2014), *reconsideration denied*, 2015 WL 1782206 (S.D.N.Y. Apr. 15, 2015); *Continental Cas. Co. v. MidStates Reinsurance Corp.*, 1-13-3090, 2014 WL 5761928 (Ill. App. Ct. Nov. 4, 2014); *Utica Mut. Ins. Co. v. Clearwater Ins. Co.*, No. 6:13-cv-1178, 2014 WL 6610915 (N.D.N.Y. Nov. 20, 2014); *but see TIG Premier Ins. Co. v. Hartford Accident & Indem. Co.*, 35 F. Supp. 2d 348, 349-51 (S.D.N.Y. 1999) (denying reinsurer's motion for summary judgment motion on the *Bellefonte* issue because California law applied, which "is notably more willing than New York to consider extrinsic evidence in determining the true meaning of a contract").

Harry P. Cohen and Michael K. Robles are Partners at Crowell & Moring LLP and members of the Insurance/Reinsurance group. They are part of a team of more than 40 attorneys who represent and counsel insurance and reinsurance companies, brokers, agents and others in negotiations, mediations, arbitrations and litigations, and have been involved in matters involving virtually every procedural and substantive issue that relates to reinsurance. hcohen@crowell.com, mrobles@crowell.com