

# AIRROC matters

LEVERAGING LEGACY LIABILITY

## Asbestos Armageddon: Shedding Light on the "Hidden Killer"

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# Pinch Hitters

Maryann Taylor & James Veach

*We have been asked to fill the large shoes occupied by our Vice Chair and Editor in Chief, Peter Scarpato, who is recovering from surgery. We and the rest of the Publications Committee wish Peter a speedy recovery.*

Our Fall issue features a new section – On The Radar. Here we cover new and recurring issues important to the run-off community. With respect to recurring issues, hardly anything recurs more often than asbestos claims. Hence, our lead article: *Shedding Light on the “Hidden Killer,”* Connie O’Mara’s review of *Asbestos The Future Risk* written by Barbara Hadley and Tom Rennell. Future Risk takes a broad look at asbestos claims in the U.S., Europe, Russia, India, and China. Future Risk provides historical perspective and addresses why asbestos continues to affect run-off books of business. Teresa

Snider then summarizes in *Asbestos Wasteland* a July 10, 2013 AIRROC panel discussion held in New York during AIRROC’s Education Day. The panel addressed current trends in asbestos litigation and also touched on claims frequency in the U.S., the UK and Australia.

Our Think Tank section features an article by John West entitled *Managing the Past in the Future*, which explores the shelf life of an insurance exposure and the factors to consider in deciding how to move forward with legacy business. Gregory Horowitz and Alexandra McElwee fill our Toolbox with *The Insecure Search for Security in NY* which urges litigants to be careful what they ask for with respect to seeking pre-answer security from foreign carriers in New York and the odds of prevailing in their applications. In the Legalese segment, Marc Abrams and Michael Kurtis analyze the recent New York Court of Appeals decision – *USF&G v. American Re in Winners All Around?*

Carolyn Fahey reports on her busy AIRROC summer and describes what’s in store for the Fall, including, of course, the 9th Annual Commutation and Networking event scheduled for October 13-16, 2013.

Elsewhere in Matters, you will find Randi Ellias’s summaries of the Chicago Regional Education Day held in June 2013. Speakers in Chicago addressed IBNR quantification, predictive

modeling, and current regulatory trends. The Chicago program also featured a workshop on reinsurance, assignments, loss portfolio transfers, and assumption agreements. Marc Abrams, Teresa Snider, and James Veach summarize the Educational Sessions held in New York during the July 2013 membership meeting. We close this issue with Present Value, the run-off market update prepared by Francine Semaya and Peter Bickford.

As Peter would say, let us hear from you. ●



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## Errors and Omissions

The AIRROC Executive Committees, page 5 of the Summer 2013 issue, incorrectly identified the chairs of the Marketing Committee. The Marketing Committee should read: Co-Chair Mindy Kipness – AIG, Co-Chair Michael Baschwitz - Zurich.

“People on the Move,” page 35 of the Summer 2013 issue incorrectly stated that David Fields was the chief reinsurance officer when he left AIG. Mr. Fields was the President of Global Casualty when he departed AIG in April of 2013.

AIRROC Matters regrets the errors.

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# Shedding Light on the “Hidden Killer”

## A Review of *Asbestos the Future Risk*



Illustration / Rafael Edwards

*If you have worked in the property-casualty insurance industry during the past 50 years and have handled asbestos claims in any way, you understand the complexity of what has been called “the longest, most expensive tort in U.S. history.”*

You may also know that asbestos is the single greatest cause of work-related deaths in the U.K. You may even have read about or seen a recent award-winning documentary, “Danger in the Dust,” which shows people currently working with asbestos in India, unprotected from dust in mills and factories. If so, you have some idea of the virulent evolution of asbestos as an insidious poison. It is a multi-layered, complex and far-reaching disaster that spans decades, has killed and threatens the lives of hundreds of thousands of individuals and has caused the insolvency of the asbestos industry and many of its insurers. The recent book *Asbestos the Future Risk* by Barbara Hadley and Tom Rennell (Iskaboo Publishing 2013) gives readers a comprehensive overview of the evolution from miracle mineral to deadly toxin and the failings of the medical, financial, legal and regulatory arenas to deal with the harmful effects of this “unquenchable” material.<sup>1</sup>

If you have been asked by the senior management of a company over the past twenty years to explain what is going on with asbestos claims, you may have actually understood that question to mean: “Why is this costing so much and what are you doing about it?” Of course, the book cannot answer those questions but it does give you the background to understand and explain why asbestos is not going away any time soon. It also gives an extensive overview of what has not worked in the past and why.

The book starts with a history of asbestos and proceeds with a review of the etiology of asbestos related diseases, describing how asbestos impacts the body, ranging from benign plural plaques and plural thickening to debilitating asbestosis, lung cancer and mesothelioma. While *asbestosis* is caused only by sustained or heavy exposure to asbestos, it is less clear how much exposure will cause lung or other cancers. A critical fact in the continued prevalence of significant losses due to asbestos claims is that very little exposure is necessary to cause mesothelioma, a cancer of the mesothelium, the lining of various cavities in the body including the lungs, abdomen and genitals. Mesothelioma also has the longest latency period:

“From first exposure it may take up to 30 or even 50, or in some cases, 70 years for a microscopic tumor to develop,” but “it can also develop rapidly, often in cases of very heavy exposure.” After a diagnosis of mesothelioma, the average life expectancy is 12 months.<sup>2</sup>

*It is a multi-layered, complex and far-reaching disaster that spans decades, has killed and threatens the lives of hundreds of thousands of individuals...*

The dangers of asbestos first became apparent in the early 20<sup>th</sup> century and the authors’ review of regulatory history examines the “too little, too late” approach taken by the industry and governments in response to a growing awareness of diseases caused by exposure to airborne asbestos fibers. The book depicts the social and medical context of evolving medical knowledge, as well as the scope and prevalence of the use of asbestos. Ineffectual precautions were taken to prevent injury to workers mining, manufacturing and installing asbestos and asbestos-containing products. Moreover, many of the potentially

harmful exposures and injuries were unforeseen in large part due to the lack of knowledge about the low threshold for exposure and the long latency period for mesothelioma.

Against this backdrop, the book details how extensively asbestos was used in construction in the first half of the 20<sup>th</sup> century to prevent the risk of fire in rapidly growing industrialized cities and during rebuilding after both World Wars in Europe. Asbestos was abundant, cheap, and flexible enough to be sprayed as insulation, incorporated into cement, woven into fabric and, in one pernicious iteration, used in the filters of Kent cigarettes (to respond to the discovered health risk of smoking). The book also goes on to detail the shift of mining, use, and disposal of asbestos to developing countries and countries such as Russia and China who appear to have less concern for its documented hazardous properties than they do for the economic attractiveness of the industry.

Thus, the book gives us the background to appreciate the state of asbestos injuries and compensation around the world today. Claims by plaintiffs outside the core group (those exposed while actually working with asbestos in a mining, factory, or installation setting) have proliferated; these include family members of workers exposed to asbestos from a worker's clothing, people using asbestos products in home improvement, and those environmentally exposed to it in the vicinity of mines and mills. Product identification and causation issues generate considerable investigation, discovery, and litigation resulting in escalating costs and, given the sympathetic subject matter of mesothelioma victims, headline-grabbing verdicts. Compensation systems, whether they are trusts established by bankruptcy courts in the U.S., reserves held by insurers for claims in the U.S. and U.K., or state compensation schemes (in codified jurisdictions like most western European countries excluding the U.K. and Ireland) continually prove to be inadequate for the number and demands of asbestos injuries.

Furthermore, given past uses of asbestos, new critical situations have developed due to insufficient respect for the danger of exposure. These include:

- The destruction of 9/11 – the World Trade Center Health Registry estimates that over 400,000 people were exposed to a variety of toxins, including asbestos, not only during the immediate aftermath but during the rescue, recovery and cleanup efforts because insufficient respiratory protection was used;
- The aftermath of earthquakes – after Fukushima, Japanese authorities found high levels of asbestos due to both the earthquake *and* subsequent demolition and cleanup efforts;
- The deterioration of school buildings containing asbestos – fibers are released during maintenance and daily use (banging a door five times in one school building was shown to multiply fiber levels between 340 - 660 times background levels); and
- “Ship cracking” – the breaking down and disposal of obsolete ships containing large amounts of asbestos.

New exposures and the impotence of global regulatory control may have less relevance for insurance coverage in the U.S., which has been fairly consistent in excluding coverage for damage and injury due to asbestos since 1985. But, even in this market, the impact of asbestos claims is still volatile and capable of surviving attempts to quash its bloodlust.

The book provides a paradigm for current trends impacting insurance companies globally by detailing how these losses developed and evolved in the U.S.. It provides an overview of asbestos litigation in the U.S. and the often futile, but sometimes effective, attempts to control run-away litigation by courts and legislatures (both federal and state). It discusses how the courts have been over-burdened with scores of plaintiffs who are not actually sick, and how recovery for the seriously injured has been undermined by plaintiffs' firms using fraudulent medicals and submitting

fraudulent claims. The book also covers the use of bankruptcy trusts and their related issues.

Predictably, given the wide and varied use of asbestos in products as diverse as vehicle brakes and modeling clay, coupled with the insolvency of the primary manufacturing and distribution defendants, the cast of defendants has widened to include companies and other entities who were previously unknown to have any role in using asbestos. This impacts companies that may have unknowingly purchased an entity with latent asbestos exposures and drives litigation costs higher as defense counsel fight to defend such entities against becoming a juicy target for swarms of claims.

*Compensation systems ... continually prove to be inadequate for the number and demands of asbestos injuries.*

Not only has the stream of mesothelioma plaintiffs failed to dissipate, it appears that the settlement or verdict value of mesothelioma cases is increasing. Thus, AM Best sees recent insurance industry reserve strengthening (AIG, The Hartford, Travelers, Allianz) and continued spending as an indication that the estimate of future industry exposure should be raised from the \$75 billion figure it predicted in 2009 to \$85 billion, as of the end of 2012. Citing AM Best, the book incorporates the reasons:

Amid tort reform and generally favorable judicial rulings between 2003 and 2006, insurers' asbestos losses tapered off from a high of \$8 Billion in 2002 to slightly more than \$1 Billion in 2008. Despite a 32 percent drop in such losses during 2011, the overall loss trend remains worrisome as the plaintiffs' bar has experienced success in eroding some reforms, as well as focusing on obtaining higher judgments for the more serious

## Shedding Light on the “Hidden Killer” (continued)

cases involving mesothelioma... given the long latency period between exposure to asbestos and the manifestation of mesothelioma, as well as the very large number of people exposed over a great many years, both directly and indirectly, it is likely that asbestos losses will continue to develop for many years to come.

The authors also point out that AM Best sees the California Supreme Court’s recent allocation decision in the environmental coverage case of *State of California v. Continental Insurance Co.* (allowing stacking of coverage), as a harbinger of judicial coverage interpretation in the U.S. that will maximize whatever coverage is available over a continuum from exposure to diagnosis.<sup>3</sup>

For readers interested in how asbestos losses are treated in the U.K., France, Italy, the Netherlands and Switzerland, the book provides an overview as well as background information on the production and consumption of asbestos in those countries. In regard to the U.K. in particular, it discusses the development of pro-plaintiff compensation laws under compulsory employers’ liability policies and public liability policies. It reviews the developments of the past 10 years leading up to last year’s United Kingdom Supreme Court’s ruling that “insurers on the risk at the time of exposure to asbestos are

liable to pay out on their EL policies.” The ruling did not deal with the trigger of coverage under public liability insurance policies which are still under the “Bolton” decision, in which the Court held the policy in place when the disease was discovered would be the one to respond.

*... the cast of defendants has widened to include companies and other entities who were previously unknown to have any role in using asbestos...*

Over the last six months in the U.S., asbestos losses have repeatedly generated stories in business and industry publications.<sup>4</sup> Asbestos has been called “America’s Toxic Legacy”. Based on the overview provided by *Asbestos the Future Risk*, the reader can see the tsunami of asbestos as repetitive waves of injuries, litigation, and financial losses starting in the U.S. and following unchecked in repeated waves throughout the UK, Europe, and ultimately countries such as Russia, India and China where its use is largely unrestricted. As these losses continue to generate questions and concerns about the financial impact for the insurance industry, *Asbestos the Future Risk* serves as a comprehensive

overview that will foster understanding in the industry and provide a historical context for why asbestos continues to have a significant undertow on industry financial results. ●

*The author greatly appreciates the assistance of Kate Mowll, an Associate at Mayfield, Turner, O’Mara & McBride (Cherry Hill, NJ) for her assistance in preparing this review.*

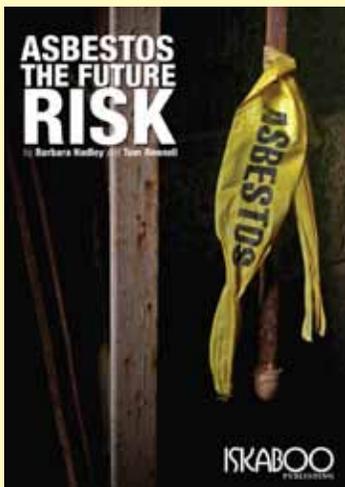
### Endnotes

1 Quite literally, the book notes that the name asbestos comes from the Latin *asbestinon*, meaning “unquenchable,” an appropriate meaning given its lust for sucking the life from victims, companies and governments.

2 The book also provides an overview of the types of asbestos fibers: amphibole (crocidolite and amosite) and serpentine (chrysotile). The latter is the more abundant and the former the more deadly, but “[a] rigorous review of the epidemiologic evidence confirms that all types of asbestos fibre are causally implicated in the development of various diseases and premature death.” *Id.* at p. 33 (quoting the Joint Policy Committee of the Societies of Epidemiology statement of June 2012).

3 Actuaries in both the U.S. and U.K. have found the final section of the book, “Reserving for Asbestos Claims,” one of the most interesting because of its discussion of the trends impacting insurers in the U.S., U.K. and Europe.

4 On March 11, 2013, The Wall Street Journal ran an article, “Asbestos Claims Rise, So Do Worries about Fraud,” and then another follow-up on the same topic on May 19, 2013. On May 5, 2013, they ran an article entitled, “Mesothelioma Doctors Lawyers Join Hunt for Valuable Asbestos Cases,” and in June, “For One Asbestos Victim, Justice is a Moving Target,” which described the fate of a mesothelioma victim and the difficulties encountered in attempting to investigate and identify the potential sources of asbestos exposure.



### Asbestos the Future Risk

By Barbara Hadley and Tom Rennell  
(Iskaboo Publishing 2013)

156 pages, soft cover, may be purchased by AIRROC members at a discounted price of USD \$170.00; please type AIRROC in the box on the order form marked ‘discount’. The website is: <http://runoffandrestructuring.com/asbestosclaims>.



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# The Asbestos Wasteland

Summarized by Teresa Snider

## Overview of the Current Landscape



From left: Brad Drew, PACE/Navigant; Michelle George, Chadbourne & Parke; Maysem Elmaet, QBE Group; Richard Murch, RiverStone Resources.

### *Current trends in asbestos litigation and future risks relating to asbestos exposures were highlighted in a panel discussion during AIRROC's Education Day on July 10, 2013.*

Bradley Drew, Managing Director of PACE Claims Services (a subsidiary of Navigant), Maysem Elmaet, Legal Counsel at QBE Group, Michelle George of Chadbourne & Parke, and Richard Murch, Supervisor in the Claims Department of RiverStone Resources LLC, provided their perspectives on legal issues relating to asbestos in the United States, the United Kingdom, and Australia.

Bradley Drew provided statistics regarding the number, type, and geographic distribution of asbestos complaints filed over the past few years. Using information gathered through Pace Claims Services' tracking of every asbestos complaint filed in the United States, Drew explained that of the approximately 6,000 to 8,000 new complaints that were filed each year, between 2,000 and 2,500 allege mesothelioma claims. During 2012, the majority of complaints alleging mesothelioma were filed in Madison County, Illinois. There has been an increase in the number of cases brought based on secondary exposure to asbestos, with 25% of the mesothelioma cases alleged to be the result of secondary exposure. In addition, it appears that some of the mesothelioma cases result from the misdiagnosis

of lung cancer as mesothelioma. Drew also explained that advertising has been effective in concentrating plaintiffs' asbestos work in a core group of law firms, including one which has focused on attracting clients with lung cancer.

The legal landscape in the United Kingdom and Australia differs significantly in that the majority of cases in those jurisdictions are against employers. However, as Michelle George explained, employer's liability insurance was not compulsory in the United Kingdom until 1972, and many insurers that issued employer's liability policies are now insolvent. Legislation is pending in the United Kingdom that would permit a mesothelioma claimant who cannot trace an insurer to recover 70% of the average pay-out for claimants in his or her age range. The money to fund these payments would come from the live insurance market. Where insurance policies covering an asbestos claim can be identified, the market practice is that the insurer with the deepest pocket handles the claim and then informally seeks recovery from other insurers based on time on the risk. Michelle also noted that the English courts have bent over backward to allow asbestos claims. One aspect of this deference is the implementation of a modified test for causation with respect to mesothelioma that only requires a claimant to show that asbestos exposure resulted in a material increase in risk.

Maysem Elmaet addressed asbestos claims in Australia. She explained that Australia has experienced three waves of claimants for asbestos-related bodily injury claims, the first comprised of miners, the second of construction workers, and the third of do-it-yourself home renovators.

*... approximately 6,000 to 8,000 new complaints that were filed each year, between 2,000 and 2,500 allege mesothelioma claims.*

This last wave of claimants is not altogether surprising since houses in Australia that were built before the mid-1980s are highly likely to have some asbestos-containing materials. Indeed, it is unlikely that this third wave will be the last due to the extensive use of asbestos-containing construction materials in Australia. It was discovered earlier in 2013 that efforts to install a National Broadband Network in Australia exposed residents and contractors to asbestos from old telecommunication pits where work was not performed in compliance with asbestos handling guidelines. The long latency period for some asbestos-related diseases means that the impact of this exposure will not be certain for decades. However, the Australian government recently created a National Asbestos Exposure Register to record



cutting through complexity

# Run-off Matters

A dynamic regulatory environment and the constant pressure to deliver shareholder value in these challenging times, is placing increasing demands on the management of discontinued business.

With our deep industry experience and sector expertise, KPMG's Insurance Restructuring teams based across our global network can assist you offering a clear road map for your run-off, advising on implementing best practice and helping you to manage and deploy capital more efficiently within your business.

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## The Asbestos Wasteland (continued)

the personal information of people who think they may have been exposed to asbestos-containing materials. Elmaet also pointed out that, as in the United Kingdom, the standard for proving causation in mesothelioma cases has been relaxed, with only proof of exposure to asbestos required. A recent case found that performing six hours of repair work in a James Hardie Industries factory was sufficient to establish exposure to asbestos. For lung cancer claims, however, the claimant needs to prove that asbestos exposure materially contributed to or caused the lung cancer.

Richard Murch focused his comments on developments at the front line of asbestos litigation in the United States. Because there has been an overall decrease in the volume of asbestos claims, courts

have been able to engage in a more focused review of the merits of claims. As a result, defendants have been able to advance viable defenses, such as lack of causation and the absence of a duty owed by a premises owner to a plaintiff whose disease is the result of second hand exposure. In addition to challenging the claimants with respect to the dose and duration of exposure necessary to prove causation, defendants are also pursuing new medical information. For example, one study showing that individuals with exposure to radiation have a higher incidence of mesothelioma than the general population suggests that asbestos may not be the only cause of mesothelioma.

The panel discussion highlighted the potential impact that legal, social, and

medical developments, from asbestos exposure registries to advertising to diagnostic tools, may have on the future of asbestos claims and the importance for insurers and reinsurers of monitoring the trends. ●



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## Announcing the AIRROC/R&Q 9th Annual Commutation & Networking Event!

The AIRROC Board of Directors and R&Q are looking forward to welcoming you to our annual event on October 13-16, 2013 at the Sheraton Meadowlands Hotel and Conference Center in East Rutherford, New Jersey. We have a new format that is sure to please!

### Event Highlights

Monday's Keynote Speaker: **Kenneth Kobylowski, NJ Commissioner of Insurance**

Women's Luncheon Keynote Speaker: **Mairi Mallon, CEO, Rein4ce**

The announcement of the **AIRROC Run-Off Person of the Year**

- **New:** Consolidated Agenda
- **New:** Hotel closer to Manhattan
- **New:** Tuesday evening reception/ dinner cruise aboard the state of the art Hornblower Hybrid yacht around New York City Harbor

- **New:** Two half-day education sessions with CLE credit (8-12) on Monday and Tuesday
- **New:** Reserved meeting tables all day Monday and Tuesday

### Education Session Themes

- **Day 1 – Resolving Disputes Efficiently:** Featuring an interactive AIRROC DRP Roadmap and a discussion of the pros/cons of dispute resolution mechanisms. Speakers include representatives from Barger & Wolen, Berkshire, Locke Lord, R&Q, Resolute UK, ROM Re, Stroock, The Hartford, and The Travelers.
- **Day 2 – A Look Ahead: What is Around the Corner?** Sessions on the Future of Runoff, ORSA, and a Regulatory Update. Speakers include representatives from Armour

Group, Crowell & Moring, Edwards Wildman, Freeborn & Peters, Mound Cotton, NJ Insurance Department, NY Department of Financial Services, PwC, R&Q, RAA, and Zurich.

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**We look forward to seeing you there!**

Contact: Carolyn Fahey, AIRROC Executive Director, [carolyn@airroc.org](mailto:carolyn@airroc.org) or visit <http://www.airroc.org/rendez-vous>

# Managing the Past in the Future



Illustration / Rafael Edwards

*In 1976, one of the classic movies of all time was released – The Gumball Rally. It was a thrilling epic of muscle cars, muscle heads and a very shallow plot. However, there was one memorable quote by Raul Julia which always comes to mind when I back out of the driveway in the morning. He turns to his navigator and says, “and now my friend, the first-a rule of Italian driving. [Franco rips off his rear-view mirror and throws it out of the car]. What’s-a behind me is not important.”*

The sentiment is sometimes reflected in today’s mad cap world of insurance. There are certain companies that feel their “legacy” business is of the past and should remain there. They prefer to focus on the bright road that lies ahead. They want to see new lines of business, premium flow, low loss ratios, claims which appear one day and don’t hang around forever. They prefer *not* to keep looking over their shoulder at what has passed. However, the past doesn’t fade into the distance – no matter how fast you drive.

In a perfect world, a risk which an insurance company has underwritten will produce no long term exposure beyond what was expected. An exposure will incur loss within a certain number of years. Those losses will then be managed for an additional length of time. That exposure will then end. Loss ratios will be contained and the underwriting year can close out cleanly.

Unfortunately, that is not always the world in which we live. The underwriter on the original policy inherently builds in certain factors to his or her pricing. I am not an underwriter and my comments related to this process are meant to bolster the larger point I am laying out. Basically, in the underwriting process, the purpose is to ultimately make a profit. To do that, each risk needs to be evaluated and controlled. The pricing will be based on determining the type of risk, the size of the exposure, the length of time that exposure will be covered, the cost it will require to control that exposure, the ultimate financial impact of that exposure to the insurer and market perception of how well the insurer addressed each of these factors.

I would like to look at a few of these factors: length of time, cost, ultimate financial impact and market perception.

One general perception of run-off is that it arises from liability exposure that sticks around long after the premium has dried up. When that happens, executive management starts to look at the outstanding liability from a different perspective. What does it cost the company to manage that liability? How confident are they of the continued exposure to that liability? How volatile is that exposure? Could they be using their staff on other business instead of the aged liability issue? There are many, many more questions to be addressed.

*... in the underwriting process, the purpose is to ultimately make a profit. To do that, each risk needs to be evaluated and controlled.*

Since an insurer is in the business of effectively managing risk, executive management needs to be aware of all cost containment measures, as well as market perception issues, when deciding how to move forward with their run-off exposure. A review of their expectations

of the original underwriting is the first step, followed quickly by a snapshot of what is happening with that book today. If the underwriting only allowed for an exposure of three years with claims management beyond that of another three years, why is the company still dealing with claims issues 10 years past the expiration date of the contract? Based on the current snapshot, how many of their staff are being utilized on this “type” of business? What is the cost of those staff members, including the overhead cost associated with them (benefits, office space, lighting, etc.)?

Let’s use the following scenario: an insurer or reinsurer has a team of 10 people fully dedicated to claims, accounting and reinsurance related to a book, or books, of business which expired 20 years ago. There is no premium flow to offset the cost of those staff members. The loss ratio on the original business has long since exceeded 200%. Of the \$20 million in outstanding reserves, investment income is currently generating around 3.5% per year. That equates to \$700,000. Those 10 staff members and their associated costs could total \$1.14 million per year. Just on the face of it, there is a huge disparity between the income and outgo on this aged business! Commutations, if they are being accomplished, may or may not be providing additional income. It is almost as simple as drawing a graph with an X and Y axis showing the intersection of cost over length of time. Where the intersection occurs is the point at which consideration must be given to future action.

What is the solution? Continue to manage the claims through closure, outsource the management of that business, or sell the book of business.

There is no singular solution for all companies. What each company decides to do must fall in line with a combination of factors: cost, utilization of staff, reputation (for better or worse) and future trend of the company.

When considering the above (cost, staff, reputation and the future), each factor can be applied to each scenario (continue as-is, outsource, or sell). Consider the “as-is” scenario. What management should do when looking at a snapshot is to evaluate internal claims processes, determine commutation plans, audit exposures directly and review on an annual basis whether this scenario is still in line with the mission and philosophy of the company. In this process, thought needs to be given to proper utilization of resources, whether to keep it in-house or out-source.

*... Properly utilized, outsourcing has a place in managing run-off. The question is to what degree and in what capacity.*

For example, when I was thinking about putting in a garden this summer, I had to consider what the best use of my cash was when it came to using a roto-tiller. Should I spend \$500 on a new tiller that I may only use once every five years, or should I spend \$100 for a couple of days this year since I only plan on doing this once? That is the beauty of outsourcing. There are expert resources which can be utilized for any amount of time at a reasonable amount of money, for any project. The quality of attention and the great reduction in long term cost is a major consideration in the “as-is” scenario described above.

Should the company decide to retain their business, it is to their great benefit to have an independent third party expert conduct a business-process evaluation. Having an objective analysis done by someone who knows industry best-practices and can best advise on how one’s company measures up to benchmarks is a valuable tool. Additionally, this company should consider a similar evaluation of their existing reserves. Chances are, a review of that nature will pay for itself,

regardless of whether reserves increase or decrease.

In the scenario where a company may consider outsourcing the management of a portfolio of business or the management of the company altogether, the same thinking applies, only on a larger scale. What is the cost/benefit of letting a group of people who are expert at controlling exposure manage it on specific lines of business, from an aged perspective. Management must determine the point where their claims have exceeded the normal life span and have now entered territory where the claims are encountering difficulties which were unforeseen in the original underwriting of the account. What are the indicators? Besides the length of time a claim has been managed, the cost of managing that legacy business must be considered. Not only the actual cost, but the opportunity costs as well. For what part of their ongoing business could the company be utilizing staff and cash resources instead of watching over-aged business? Legal cost should also be evaluated differently on an aged claim.

Properly utilized, outsourcing has a place in managing run-off. The question is to what degree and in what capacity. Cost is a consideration. However, management must really investigate what that means. What about “opportunity cost”? What are they missing by not utilizing their staff for core services and current issues? Bringing in a third party provides objectivity, a view of best practices and an opportunity to evaluate how the organization should move forward. ●



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# The Insecure Search for Security in NY

## Foreign Cedents in New York Seeking Pre-Answer Security

*In a global coverage environment, when policyholders or ceding carriers are forced to sue their insurers to collect, the list of defendants often includes an “unauthorized insurer,” which is an insurer not licensed to sell insurance in the state where the suit was brought.*

In New York, a jurisdiction for which many companies with international insurance and reinsurance programs consent to both its selection as a forum and its substantive law, these responding foreign carriers are often subject to an important “pre-answer security” requirement to protect the litigants and court from a situation in which the New York judgment could not be executed or otherwise subject to collection. *See* New York Ins. Law § 1213 (“Section 1213” or “§ 1213”). In laymen’s terms, before these foreign insurers may answer a complaint against them, they often must post cash, securities, or a bond sufficient to satisfy any judgment that might be entered against them to avoid additional collection and satisfaction hurdles. *See* § 1213(c)(1).<sup>1</sup>

Section 1213(c)(1) provides that: “[b]efore any unauthorized foreign or alien insurer files any pleading in any proceeding against it, **shall** either: (A) deposit with the clerk of the court in which the proceeding is pending, cash or securities . . . or (B) procure a license to do an insurance business in this state” (emphasis added). Certain court decisions interpreting the intent of this provision in light of other statutory protections, however, cast doubt on the availability of such pre-answer security under § 1213(c)(1), of which a collecting party must be aware. This article focuses upon one of those anomalies in the application of the New York pre-answer security statutory scheme. Specifically, this article examines briefly whether, in those instances where a New York forum and



Illustration / Rafael Edwards

New York substantive law were expressly agreed upon by the foreign carrier and the counter party in an insurance or reinsurance contract, § 1213(c)(1) is applicable if the policy-holder and ceding carrier are neither a “resident” of, nor otherwise “authorized” to do business in, New York.

*Certain court decisions . . . cast doubt on the availability of such pre-answer security under § 1213(c)(1), of which a collecting party must be aware.*

In executing an insurance or reinsurance contract, a foreign carrier and its counterparty often expressly subject themselves to a certain jurisdiction’s forum or choice of law in the event of a dispute. By consenting to such clauses, courts have held

the parties shall comply with all substantive and procedural requirements of New York law. *See, e.g., Union Bancaire Privee v. Nasser*, 751 N.Y.S.2d 440 (1st Dep’t 2002). Some New York courts, however, have expressly determined that foreign defendant insurers are not subject to the pre-answer security requirements of §1213(c)(1), despite their prior consent to New York substantive law, if the party seeking to enforce § 1213(c)(1) is neither authorized to do business in, nor a resident of, New York. *See, e.g., Allstate Ins. Co. v. Administratia Asigurarilor De Stat*, 875 F. Supp. 1022, 1027 (S.D.N.Y. 1995). These determinations are largely based on differing interpretations of and nuances in § 1213(c)(1) of which parties with New York choice of law and forum selection clauses should be mindful.

Indeed, there appears to be a consensus that one important purpose of §1213(c)(1) is to ensure there will be adequate funds or security located in New York to satisfy

a judgment against a foreign defendant insurer which is not a resident of nor authorized to do business in New York. See *Levin v. Intercontinental Cas. Ins. Co.*, 95 N.Y.2d 523, 527 (N.Y. 2000). The statute advances these goals by “requiring a foreign carrier to post a bond at the outset of a proceeding.” *Id.*; see also *T.P.K. Construct. Corp. v. Southern American Ins. Co.*, 739 F. Supp. 213, 215 (S.D.N.Y. 1990) (“The language of Section 1213(c)(1) mandates that a security ‘shall be deposited whenever an unauthorized foreign insurer files a pleading”). While § 1213(b) explains how an unlicensed alien insurer may be subjected to personal jurisdiction in New York through substituted service of process through the state superintendent of insurance, the New York Legislature also included the *separate* security requirements of § 1213(c)(1) in the statute for defendant alien insurers to ensure that “a foreign carrier’s funds will be available in [New York] to satisfy any potential judgment against it from the proceeding.” *Levin*, 95 N.Y.2d at 527. As New York courts have noted:

New York Insurance Law § 1213 was enacted to accomplish two separate goals: (i) to subject unauthorized insurers to personal jurisdiction in New York; **and** (ii) to ensure that sufficient funds would be available to satisfy any judgment rendered in an action against an unauthorized insurer.

*AIU Ins. Co. v. Certain Underwriters at Lloyd’s London*, 2008 N.Y. Misc. LEXIS 9878, at \*4-5 (Sup. Ct., N.Y. County May 5, 2008) (quoting *Travelers Ins. Co. v. Underwriting Members of Lloyds*, Index No. 60024/95-001 (N.Y. Sup. Ct. Apr. 5, 1996)) (emphasis added).

Courts have disagreed on the scope of § 1213(c)(1). The New York Court of Appeals, for instance, has suggested that courts should broadly interpret § 1213(c)(1)’s requirements, for to be guided by “nomenclature [rather than by] the realities of litigation . . . would impede Section 1213’s objectives.” *Levin*, *supra*, 95 N.Y.2d at 527. The

“realities of litigation” dictate that when a foreign carrier affirmatively and expressly chooses New York law and a New York forum, its counterparty should be afforded the pre-answer security protections of § 1213(c)(1) – especially since courts have held that the general purpose of the provision is to ensure that there will be adequate funds located in New York state to satisfy a judgment. When a party enters into litigation in New York with the benefits of an agreed New York forum and New York substantive law, it logically follows that a prevailing party seeking to collect against its foreign carrier would likewise want to be assured that its counterparty carrier has adequate funds in New York to satisfy a judgment by New York courts. Otherwise, the New York courts’ efforts to achieve closure through the state’s judicial system, and the parties’ resources, could potentially be mooted or minimized by a hollow verdict secured by the policyholder or ceding company against a foreign carrier without sufficient collectible funds in the same jurisdiction.

In interpreting the scope of the provision, however, some courts have a narrower view on the scope of § 1213(c)(1). These courts have cited to § 1213(a), which states that in providing a method of substituted service of process upon foreign insurers, the New York legislature was “exercis[ing] its power to protect its **residents.**” § 1213(a) (emphasis added). Some courts have thus relied on this provision in support of the proposition that non-resident, unauthorized parties seeking collection under insurance or reinsurance contracts are outside the scope of protections afforded by § 1213(c)(1) because § 1213(a) only refers to New York “residents” involved in coverage disputes with their foreign carriers. See, e.g., *Duke Bridge LLC v. Security Life of Denver Ins. Co.*, 2011 WL 2971392 (E.D.N.Y. July 20, 2011); see also *Quanta Specialty Lines Ins. Co. v. Investors Capital Corp.*, 2008 WL 1910503 (S.D.N.Y. Apr. 30, 2008). In essence, such decisions have taken the language in § 1213(a) to create an implied residency requirement for the collecting party in § 1213(c)(1) that is not plainly

stated (and certainly not self-evident) in the latter sub-sections relating to the security that “shall” be posted before an answer can be filed.

*... such decisions have taken the language in § 1213(a) to create an implied residency requirement for the collecting party in § 1213(c)(1) ...*

The scope of § 1213(c)(1) can also arguably be affected by the courts’ interpretations of the statute’s exemptions in other sub-sections. For example, § 1213(e) potentially creates an exemption from the security requirement in § 1213(c)(1) for those defendant foreign insurers who issue certain insurance contracts under either N.Y. Ins. Law § 2117(b) & (c)<sup>2</sup> and/or § 2105<sup>3</sup> if “such contract[s]” expressly designate the state superintendent of insurance as the agent for service of process for any claim arising from such contracts.

This potential exemption, however, is not straightforward. For example, it is arguably unclear on its face as to whether the express designation of the superintendent is required for contracts issued under both § 2117 and § 2105 – or if it would apply to contracts issued under § 2105. If courts determine that contracts issued under § 2117 or § 2105 are always exempt from posting security regardless of whether there was also an express designation of service in “such contract,” that interpretation could severely limit the scope of the foreign carrier security protections afforded to collecting counter-parties by § 1213(c)(1).

This article has highlighted some of the anomalies in the New York pre-answer security scheme; i.e., a non-New York policyholder or cedent that has contracted with a foreign carrier must be mindful that, even if the parties have consented to New York’s law and forum, they are not guaranteed the benefit of New York’s

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## The Insecure Search for Security in NY (continued)

statutory “pre-answer security” protections. Given the case law addressing the sub-parts of the statute, especially under those decisions implying the New York residency or business authorization requirement for foreign policyholders or cedents suing a foreign insurer, the security protections of § 1213(c)(1) may be difficult to secure. Likewise, it is possible that when the New York superintendent of insurance is expressly designated as an agent of service for the foreign carrier to ensure proper jurisdiction, the policyholder or cedent relying on the benefit of its New York choice of law and forum clause may not be afforded the protections of § 1213(c)(1) – even if the responding foreign carrier that agreed to such language has no assets in New York to secure any judgment which may be obtained through the New York courts. These are unfortunate, potential

anomalies and dangers created by judicial interpretations of the statutory scheme in those courts that are only willing to protect those policyholders and ceding companies that are residents in New York or otherwise expressly authorized to conduct business in the State. So, if your company is a foreign policyholder or cedent that may be litigating in New York and under New York law by consent, “let the buyer beware” and adjust your pre-answer security expectations and arguments accordingly. ●

3 N.Y. Ins. Law § 2105 involves certain contracts placed through NY licensed “excess line” brokers.

### Endnotes

1 See e.g., *Curiale v. Ardra Ins. Co.*, 88 N.Y.2d 268 (1996) (court ordered that defendant’s answer be stricken unless it posted a pre-Answer security under § 1213(c)).

2 N.Y. Ins. Law § 2117 (b) and (c) address certain contracts negotiated by a broker licensed in New York with an unauthorized insurer.



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# Winners All Around?

## Recent Developments in Reinsurance Law *USF&G v. American Re*



*On February 7, 2013, the New York Court of Appeals (New York’s highest court) issued a decision that has reverberated around the reinsurance dispute world. The decision – which follows more than a decade of protracted litigation between USF&G and a number of prominent reinsurers, including American Re-Insurance Co. and Excess and Casualty Reinsurance Association and its various members, explores the contours of the follow the settlements doctrine and has generated considerable interest in the reinsurance dispute community.<sup>1</sup> We provide a concise summary of the decision here.*

The dispute arose out of USF&G’s \$975 million asbestos settlement with Western MacArthur and its subsequent \$391 million billing to its excess of loss reinsurers, including American Re and the ECRA pool and its members, who had agreed to reinsure USF&G between 1956 and 1962 for losses of \$100,000 per claimant in excess of a \$100,000 per loss retention. Notably, the insurance policy as well as the reinsurance treaty had no aggregate limits, meaning that “the reinsurers could be liable for any number of losses, up to \$100,000 each.”<sup>2</sup> Although the reinsurers raised a number of different defenses over the course of the litigation, by the time the case found its way to New York’s highest court, the reinsurers were challenging USF&G’s settlement on three grounds; namely that USF&G had acted improperly by: (i) failing to allocate settlement amounts to address the insured’s assertion that USF&G acted in bad faith in the course of the coverage litigation; (ii) assigning lung cancer claims \$200,000 values (*i.e.*, the exact amount of

the per claimant limit), a sum more than double the amount estimated by an expert witness for the asbestos claimants; and (iii) allocating all of the losses covered by the settlement toward a single policy, *i.e.*, the 1959 policy, rather than spreading the losses over the many policy years in which the claimants were exposed to asbestos. Before addressing these points, the Court engaged in a detailed discussion of the follow the settlements doctrine and provided insight into how it believed an adjudicative body should consider this doctrine.

*... just because a cedent’s allocation decisions were entitled to deference did not mean they were immune from scrutiny.*

First, the Court found that a follow the settlements clause, as a general matter, requires reinsurers to defer to their cedent’s decisions on allocation and that if reinsurers wanted greater protection, “their remedy is to negotiate better terms.”<sup>3</sup>

Second, the Court explained that just because a cedent’s allocation decisions were entitled to deference did not mean they were immune from scrutiny. In particular, the Court applied a standard of “objective reasonableness” to determine whether the settlement allocation was in good faith rather than launching an inquiry into the subjective intentions of the cedent in making the settlement. This standard does not require the cedent to disregard its own interests, and where several reasonable allocations are possible the cedent may choose “the one most favorable to itself.”<sup>4</sup>

Third, in considering whether the objective reasonableness standard has been met, the settlement allocation rationale “must be one that the parties

to the settlement of the underlying insurance claims might reasonably have arrived at in arm's length negotiations if the reinsurance did not exist.<sup>5</sup> As part of this inquiry, the cedent's motives "should generally be unimportant" and any settlement structure negotiated and agreed between the ceding company and its insured is not a determinative factor.<sup>6</sup> As the Court pointedly explained, "in many cases claimants and insureds . . . , far from being indifferent, will enthusiastically support insurers' efforts to fund a settlement at reinsurers' expense. They will do this for the simple reason that insurers, like everyone else, are apt to be more generous with other people's money than their own."<sup>7</sup>

Based on these principles, the Court concluded that the first two challenges to the cession should be sent to a finder of fact for further scrutiny, while USF&G was entitled to summary judgment on the third issue.

*This decision has attracted a lot of interest from cedents and reinsurers alike – especially given the enormous amounts of money at stake.*

On the first point – *i.e.*, USF&G's failure to allocate settlement amounts toward potential bad faith exposure – the Court found that a fact finder could reasonably side with the reinsurers. The Court was persuaded by the fact that when the coverage case went to trial, USF&G faced the prospect of a large jury award against it on its bad faith claims, especially since it had lost its motion for summary judgment and since the trial court had denied USF&G's motion to exclude evidence relating to this claim. The Court also relied upon a proposal prepared by the insured's counsel shortly before

settlement, which estimated USF&G's bad faith exposure to amount to \$167 million, as well as a supervising bankruptcy court's finding that the bad faith claims had significant settlement value.

On the second point – the \$200,000 assignment of lung cancer claims – the Court found that a fact finder could fairly conclude that USF&G had assigned an unreasonably high value to these claims, especially since an expert for the insured supposedly did not view the claims nearly as richly. The Court explained that a fact finder could infer that some of the value of these claims should have been attributed toward USF&G's bad faith and, if these claims were reduced and greater values assigned to less serious claims (such as claims for asbestosis, pleural thickening and "other cancer"), the result may be significantly less reinsurance available given that the less serious claims would still fall below the \$100,000 retention. At any rate, this issue would be left for the jury to sort out.

On the third point – whether USF&G could assign all losses to the 1959 policy – USF&G fared better. While pro-rating the claims over the many policy years in which the claimants were exposed to asbestos would have resulted in the reinsurers avoiding liability, the Court held that it was not unreasonable for USF&G to assign the claims to a single year especially given California's continuous trigger, all sums and anti stacking regimes applicable at the time of the settlement, which essentially let the asbestos claimants choose any one of the policies that USF&G issued to Western Asbestos and assign their injuries to that policy. The Court also summarily dismissed the reinsurers' argument that USF&G's treaty retention had been increased from \$100,000 to \$3,000,000 on the ground that sophisticated parties would have reflected such an amendment in a more formal manner than the reinsurers had contended.

This decision has attracted a lot of interest from cedents and reinsurers alike –



Illustration / Rafael Edwards

## Winners All Around (continued)

especially given the enormous amounts of money at stake. It is unclear at this point, however, whether the decision adds in any significant way to the deep body of case law already addressing allocation, bad faith and “follow the settlements” issues. On the allocation side, as a recent commentator has insightfully pointed out,<sup>8</sup> the primary debate going forward may center on exactly what “objective reasonableness” means, especially from a procedural point of view. Put differently, when the Court speaks of “objective reasonableness,” is it suggesting that allocation issues are typically issues of fact for a jury as the ultimate interpreter of the “reasonable man” or does the decision stand for the proposition that summary disposition is appropriate as a matter of course, especially if the cedent can point to objective evidence in the record supporting its allocation? Perhaps the best guide to this question lies in the decision too, which is to say it depends

on the strength of the facts marshaled by the reinsurer to create a potential issue of fact and avoid summary judgment. In this sense, the Court’s emphasis on the individual facts of the case may have something in common with the arbitral model – or as another appeals court put it, “facts decide cases at every level and of all types.”<sup>9</sup> ●

*The views expressed in this article do not necessarily reflect the views of the firm, its attorneys or its clients.*

### Endnotes

- 1 *United States Fidelity & Guaranty Co. v. American Re-Insurance Co.*, 20 N.Y.3d 407 (2013).
- 2 *Id.* at 417.
- 3 *Id.* at 420.
- 4 *Id.* at 421.
- 5 *Id.* at 420.
- 6 *Id.* at 421.
- 7 *Id.*

8 Charles J. Scibetta, “Follow the Settlements and Allocation after *USF&G v. American Re...* The ‘Objectively Reasonable’ Standard,” *ARIAS Quarterly*(Second Quarter 2013).

9 *Doe v. Beaumont Independent School District*, 240 F.3d 462 (5th Cir. 2001).



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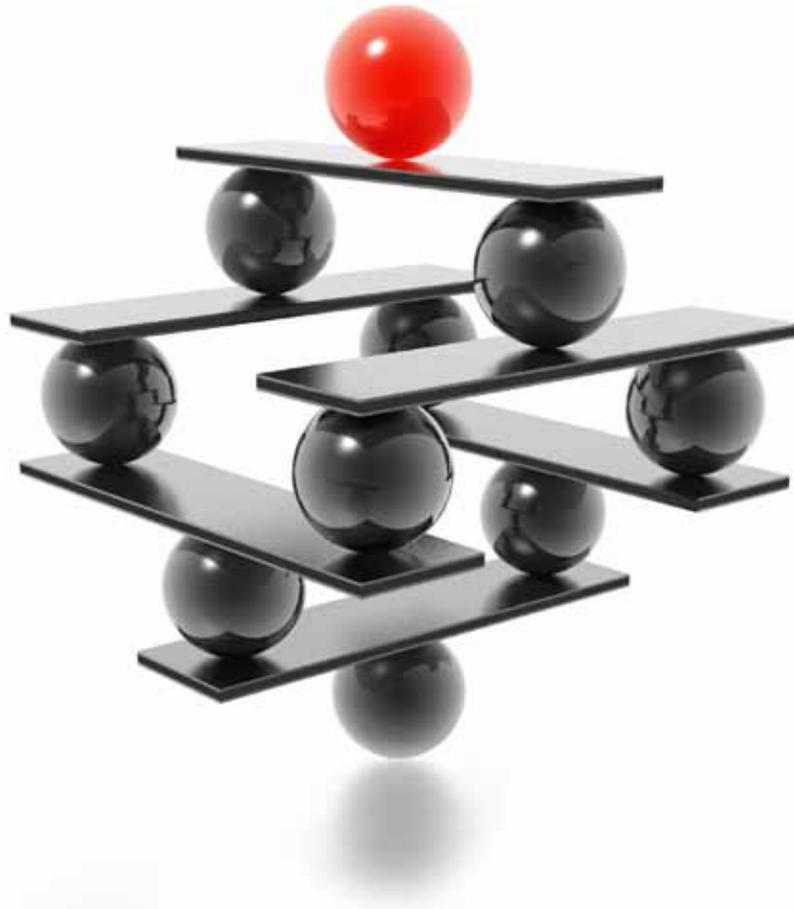
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## Message from the Executive Director

Our wonderful editors and designers have been chasing me for several weeks to get my article to them. I have finally landed in a place where I can write about my reflections of the past few months at AIRROC as well as look towards the horizon (I am sure much to their relief!)

My landing place is the Burlington International Airport, where I am on my way back to Washington, DC. I have spent the last few days at the Vermont Captive Insurance Association Annual meeting. While exhausted, I am also energized by the large number of connections that I made, the new knowledge I obtained – and, of course, I am always glad to have the opportunity to tell others about AIRROC. This was a great experience for me and I hope to come back next year.

Expanding AIRROC’s realm is one of my goals. Having a chance to take us on the road and look for new members and partnerships is especially relevant since we recently added two new membership categories – managers and brokers – to the list of eligible members of our growing organization. We welcome Devonshire and Buxbaum

Loggia who have just joined as new Managing Members.

This fall we featured two “seconds” – our second 2013 DRP Workshop in NYC and the second West Coast Regional in Newport Beach. Both of these events were positive and productive for all who attended. Read more about them in the next issue of the magazine.

Make sure that you register today for the 9th Commutation and Networking Forum at the Sheraton Meadowlands, October 13-16. We have made some exciting changes to the format and the events this year. Register today at [www.airroc.org](http://www.airroc.org).

I look forward to seeing all of you in the near future! ●



Carolyn Fahey joined AIRROC as Executive Director in May 2012. She brings more than 20 years of re/insurance industry and association experience to the organization. [carolyn@airroc.org](mailto:carolyn@airroc.org)

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# AIRROC Educational Session Summaries / Chicago



From left: Chris Walker, PwC; Barbara Murray, PwC; Ken Wylie, Sidley; Mo Masud, PwC; Andrew Holland, Sidley; Kevin Madigan, PwC; Steve Kinion, Delaware Dept. of Ins.; Keith Buckley, Fitch Ratings.

*AIRROC's second 2013 Chicago program was co-hosted by Sidley Austin LLP and PwC. Sidley offered their palatial office on the top floor of One South Dearborn with a magnificent view of the lake and the skyline. Attendees didn't have time to daydream...they were kept engaged by the knowledgeable panelists and an interactive workshop. Another top notch event for AIRROC's constituency.*

## IBNR and Legacy Business

### Defining the Issues, Evaluating and Selecting the Methodology, Contrasting Perspectives

A panel moderated by Barbara Murray, Chris Walker of PwC and Ken Wylie of Sidley Austin LLP discussed new approaches to actuarial models used for long-tail business, including the use of pension models to set reserves for workers' compensation claims. Significant issues relating to adequate reserving for long-tail business include selecting an appropriate interest rate, where the practice of selecting a rate to match the tail of the subject business may not accurately capture potential

investment return given the current interest rate environment. The panel also touched upon the importance of understanding and, where appropriate, challenging the actuarial assumptions made by a trading partner in connection with commutation discussions and/or by an opponent in a dispute.

## Regulatory: Current Issues and Trends

Kevin Madigan of PwC, Steve Kinion of the Delaware Department of Insurance, and Andrew Holland of Sidley Austin participated on a panel that led a spirited discussion of practically up-to-the-minute developments in regulatory law. Speaking first, Mr. Kinion focused his presentation on the regulation of captive insurers in Delaware. He noted that Delaware has been active in the discussions and drafting of the NAIC Model Law on Medical Stop Loss Captives and that, regardless of what happens with the Model Law, Delaware seeks and will continue to license such captives. Mr. Kinion expressed Delaware's disagreement with the recent negative comments concerning captive insurance companies set forth in the white paper released by the New York Department of Financial Services.

Mr. Holland then provided an update concerning the issues to which the New

York Department has recently turned its attention, emphasizing the prosecutorial bent of the Department and the broad power granted to the Department under New York's Insurance Law. The Department is currently focusing on: (1) alleged abuses with respect to force-placed insurance; (2) certain insurers' efforts to avoid the payment of annuities – and the consequent escheat of unclaimed life insurance benefits to the state – by searching the Death Master File to identify deceased annuitants; (3) management of cyber risk by insurance companies; (4) the use of affiliated captives, which the Department has characterized as “shadow insurance” and “financial alchemy”; and (5) private equity involvement with annuity companies.

Finally, Mr. Madigan outlined the parameters for the U.S. Own Risk and Solvency Act (“ORSA”) as currently contemplated by the National Association of Insurance Commissioners (“NAIC”). The NAIC has identified three principal objectives for the ORSA. First, the ORSA is intended as a tool to help supervisors understand the risks to which insurers are exposed and how insurers are managing those risks. Regulators plan to assess Enterprise Risk Management (“ERM”) capability and use it to guide their supervisory strategy. Second, the ORSA will be used to assess groups' own assessment and management of their capital at a group



From left: Bill Barbagallo, PwC; Tim Corley, Inpoint; Jim Sporleder, Allstate; Bill Sneed, Sidley; Sheila Carter, Zurich; Bill Sneed, Sidley; attendees engaged in negotiation during the LPT Workshop.

level. Lastly, the NAIC intends that the ORSA will help foster effective ERM strategies at all insurers. The ORSA will be implemented in 2015, and there is no one-size-fits-all filing requirement. Rather, each insurer is expected to tailor its filing to its own operation.

## Keynote Address

As the keynote speaker, Keith Buckley, Managing Director and Head of Global Insurance Ratings at Fitch Ratings, described the process employed by Fitch in arriving at ratings for insurance companies. He emphasized that Fitch sought transparency in the process and advised that while Fitch is not receptive to arguments that its ratings criteria are flawed, Fitch appreciates that certain situations require a nuanced application of the criteria. Mr. Buckley further advised that the appeals process for companies seeking to challenge ratings was recently revised to allow companies additional time to formulate their appeals.

## Predictive Modeling

Mo Masud of PwC examined the emerging discipline of predictive analytics, and the reasons why the use of predictive analytics has become a strategic differentiator among insurance carriers. Particular applications discussed included the identification

of target customers and development of a marketing strategy to attract those customers, segmentation within classes of business to exploit gaps in traditional ratings plans, and the determination of customer lifetime value. Mr. Masud also noted that because the predictive modeling cycle totals approximately five years, as distinguished from the six-month to one-year renewal cycle for CGL policies, certain carriers were increasing the terms of their CGL policies to better employ predictive analytics.

## The View

### Today's Insurance/Reinsurance Headlines

Bill Barbagallo of PwC led a program in which Tim Corley of Inpoint, William Sneed of Sidley Austin, James Sporleder of Allstate, and Chris Walker of PwC debated hot topics in insurance and reinsurance. Among the topics discussed was the tension between the universal desire to control the costs of arbitration and the universal hesitancy toward using less experienced, and potentially less costly, arbitrators. In addition, the panel discussed the potential implications of the recent *United States Fidelity & Guaranty Co. v. American Re-Insurance Co.* case, in which the Court of Appeals of New York held that the “follow the fortunes” doctrine applied to allocation decisions, and ruled that the applicable

standard was whether the allocation was “objectively reasonable.” 20 N.Y.3d 407, 420. Finally, the Panel discussed how the recent M&A activity in the industry has resulted in companies doing business with trading partners with whom they never intended to do business and whether, and if so how, that fact has impacted disputes.

## Reinsurance and Loss Portfolio Transfers, Issues of Assignment

As background for the afternoon workshop, Thomas Cunningham and Sean Keyvan, both of Sidley Austin LLP, elucidated the differences among assignments, loss portfolio transfers, and assumption agreements, describing the benefits and pitfalls inherent in each structure. The topics discussed included whether a reinsurance agreement is analogous to a personal services contract, precluding assignment even where no anti-assignment provision exists, and that an assumption agreement must be tri-partite, including the cedent, the original reinsurer, and the assuming reinsurer, in order to ensure enforceability. ●

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# AIRROC Educational Session Summaries

## New York



Top row: Craig Brown, RiverStone; Robert Sweeney, CNA; Teresa Snider, Butler Rubin; Alexandra Furth, Liberty Mutual. 2nd row: Deborah Minkoff, Cozen; Edward Ellis, Markel; Richard Mason, Cozen.

*Summer in the City with AIRROC! On July 10, 2013, AIRROC held its Summer Membership meeting hosted by Chadbourne & Parke LLP in their conference center at 30 Rock. Drawing the largest crowd for a summer meeting in several years, the room was humming with the sounds of AIRROC members engaged in meetings, networking, and learning from several expert panels. Read on to see what was covered...*

## Sexual Molestation Risks: Emerging Claims Issues

Summarized by Marc L. Abrams

Edward Ellis (Markel), Alexandra Furth (Liberty Mutual), Richard Mason (Cozen) and Deborah Minkoff (Cozen) presented a panel discussion entitled “Sexual Molestation Risks Impacting Reinsurers.” The panel discussion explored molestation risks from a number of different angles.

Initially, Mr. Mason provided a detailed and highly informative survey on recent

trends, including a discussion on how molestation claims are no longer confined to religious institutions, but are now a recognized exposure for educational institutions (particularly when minors visit campuses through day camps or residential camps), as well as for other businesses serving minors, such as hospitals and other health care providers. This discussion was followed by a survey of various states’ “reviver” laws – in other words, when a state relaxes or lengthens the statute of limitations for sexual molestation claims – as well as a lively discussion on insurance coverage issues, which was led by Ms. Minkoff and Mr. Ellis. As these panelists effectively explained, molestation claims can raise a

multitude of insurance coverage issues, including whether the conduct at issue constitutes a bodily injury and whether coverage can be denied based on the insured’s prior knowledge of the improper behavior. Molestation claims also suffer from different approaches to allocation and trigger, and while case law from the environmental sphere may provide some guidance for litigants, molestation claims have their own unique elements, including the existence of victims and perpetrators, episodic conduct that need not be continuous, and harm that is manifested rather than latent. Another interesting point the panelists reinforced was that courts considering molestation coverage issues did not typically strain

logic to reach a result in favor of the party seeking coverage, which probably came as a refreshing surprise to many of the clients and practitioners in the room.

While courts throughout the US have been grappling with molestation coverage issues for some time now, reinsurance case law is particularly scarce, as Ms. Furth explained in her edifying discussion of reinsurance issues. Without any guidance from the courts, there continues to be significant grounds for potential disagreement between cedents and reinsurers on molestation claims, particularly given the interplay between applicable retentions and allocation theories, which could offer substantially different recovery outcomes depending on whether the losses are grouped by occurrence-per-perpetrator, occurrence-per-perpetrator-per-year, or per-victim-per-year, as Ms. Furth demonstrated. Beyond these differences, reinsurance contracts may also have different occurrence language than that contained in the underlying coverage, as well as different choice of law provisions. The bottom line is that molestation claims present a number of complex insurance and reinsurance coverage issues, which we may see more of, especially given new sources of litigation involving molestation claims.

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## Update on Recent Legal Developments

Summarized by Teresa Snider

Craig R. Brown, Vice President and Deputy General Counsel of RiverStone Claims Management, LLC, Robert E. Sweeney, Jr., Senior Litigation Attorney at CNA, and Teresa Snider of Butler Rubin Saltarelli & Boyd LLP provided an update on recent legal developments.<sup>1</sup>

Bob Sweeney began with a summary of *United States Fidelity & Guaranty Co. v.*

*American Re-Insurance Company*, 20 N.Y.3d 407 (N.Y. 2013), in which the New York Court of Appeals held that a follow-the-settlements clause generally requires reinsurers to defer to a cedent's allocation decisions, but factual disputes as to the objective reasonableness of the allocation precluded summary judgment. Craig Brown then described two recent decisions addressing allocation in the insurance context. In the first case, *John Crane, Inc. v. Admiral Insurance Co.*, No. 1-09-3240, 2013 Ill. App. LEXIS 358, 2013 IL App (1st) 093240-B (Ill. App. Ct. June 4, 2013), the court addressed multiple issues, including horizontal exhaustion, allocation, "all sums," trigger, and the impact of a carrier settlement. In the second case, a California trial court ruled in *Plant Insulation Co. v. Fireman's Fund Insurance Co.* that the continuous trigger determination in *Armstrong* is still accurate. The court additionally held that aggregate completed operations limits apply to operations claims for any triggered policy incepting after the operations were completed, even if the given claimant was only exposed during operations. Allocation between insurance policies was also the subject of *Kaiser Cement & Gypsum Corp. v. Insurance Co. of State of Pennsylvania*, 215 Cal. App. 4th 210 (Cal. Ct. App. 2013), which was summarized by Teresa Snider. The *Kaiser* decision has since been decertified by the California Supreme Court.

*Pine Top Receivables of Illinois, LLC v. Banco De Seguros Del Estado*, pending in the U.S. District Court for the Northern District of Illinois, like the *Kaiser Cement* case, demonstrates the importance of the contract language at issue to a case's outcome. In *Pine Top Receivables*, a key issue was whether the liquidator had assigned only the right to collect reinsurance recoverables or whether the right to arbitrate with the reinsurer was subsumed within the assignment. 2013 U.S. Dist. LEXIS 28040 (N.D. Ill. Feb. 25, 2013). The court concluded that, under the terms

of the contract, the right to arbitrate had not been assigned; that decision is the subject of an interlocutory appeal to the Seventh Circuit.

The next case discussed was *Standard Fire Insurance v. Knowles*, 133 S. Ct. 1345 (2013), in which the Supreme Court unanimously held that a potential class representative's stipulation that a proposed class would not seek more than \$5 million was not binding on members of the proposed class and did not defeat federal jurisdiction under the Class Action Fairness Act if the matter in controversy exceeds \$5 million in sum or value.

Next, Craig Brown discussed Oregon Senate Bill 814, which was signed into law on June 10, 2013. The legislation amended the Oregon Environmental Cleanup Assistance Act, retroactively negating assignment clauses, affecting non-cumulation clauses, and largely eliminating the effectiveness of owned property exclusions. It remains to be seen whether the retroactive application will be enforceable.

Bob Sweeney discussed *AIU Insurance Co. v. TIG Insurance Co.*, 2013 WL 1195258 (S.D.N.Y. Mar. 25, 2013), in which the court applied Illinois law in determining that timely notice to the reinsurer was a condition precedent to coverage under the reinsurance contracts at issue. The case is currently on appeal.

The next few cases discussed, including *Midwest Family Mutual Insurance Co. v. Wolters*, 831 N.W.2d 628 (Minn. 2013) (carbon monoxide poisoning from a faulty furnace installation not covered due to absolute pollution exclusion) and *Mountain States Mutual Casualty Co. v. Roinestad*, 296 P.3d 1020 (Colo. 2013) (policy excluded claim resulting from hydrogen sulfide gas poisoning caused by discharge of cooking grease into sewer system), interpreted and applied pollution exclusions.

<sup>1</sup> As stated in the presentation, any views expressed during the session, or in this summary, do not necessarily reflect the views of any of the presenters, their employers, affiliates, law firms, and/or clients.

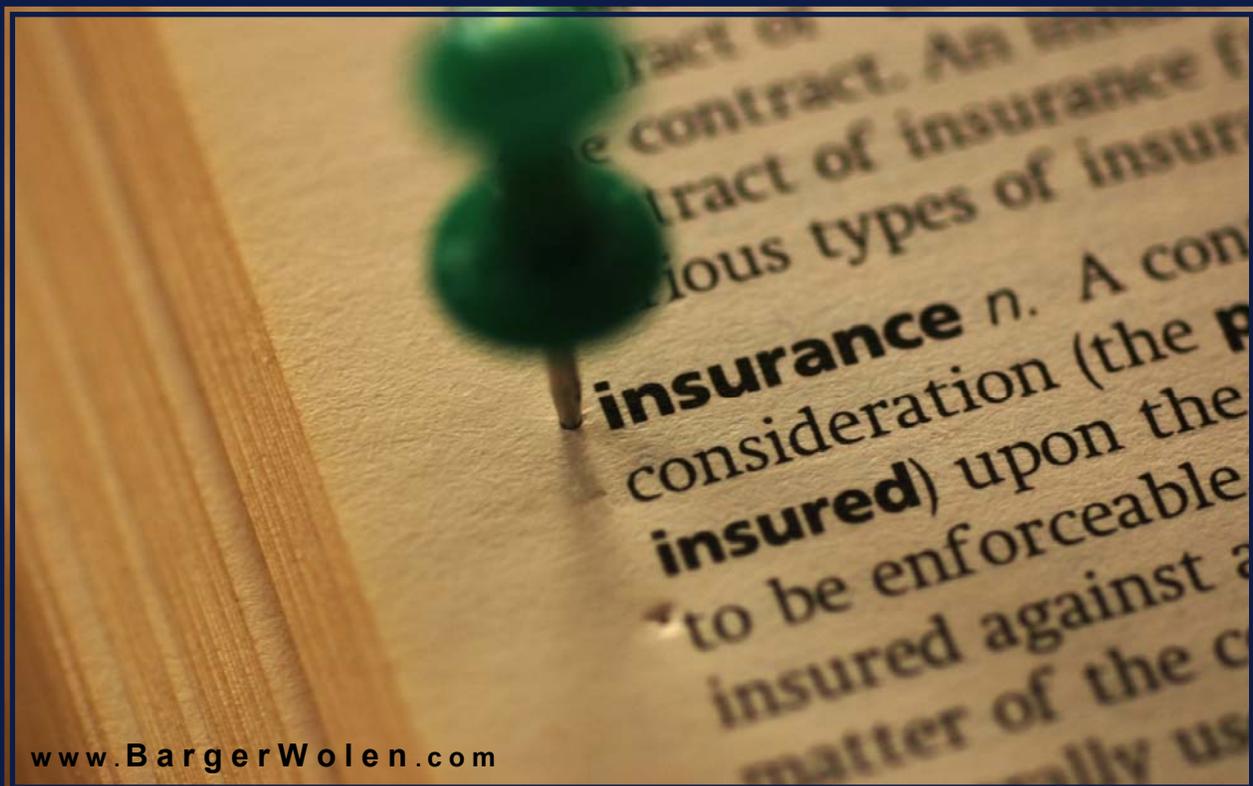
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## AIRROC Educational Session Summaries / New York (continued)



photos / Jean-Marc Granbert

From left: Rudy Dimmling, Alvarez & Marsal; Christina Reisinger, Alvarez & Marsal; John Roberts, Edwards Wildman; Ellen Relkin, Weitz & Luxenberg.

The final three cases addressed the consequences of litigation strategy. In *New Hampshire Insurance Co. v. Magellan Reinsurance Co.*, 2013 Tex. App. LEXIS 5437 (Tex. Ct. App. May 2, 2013), the Texas appellate court upheld the trial court's denial of a motion to compel arbitration, finding that the cedent was judicially estopped from shifting its position concerning arbitrability. In *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064 (2013), the Supreme Court ruled that because the parties agreed to have the arbitrator decide whether an arbitration clause authorized class arbitration, the arbitrator did not exceed his powers in so doing. Finally, in *K2 Investment Group LLC v. American Guarantee & Co.*, 2013 N.Y. LEXIS 1461 (N.Y. June 11, 2013), the New York Court of Appeals held that, "when a liability insurer has breached its duty to defend its insured, the insurer may not later rely on policy exclusions to escape its duty to indemnify the insured for a judgment against him."

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## Claims (Present and Future) Arising from Failed Medical Devices

Summarized by James Veach

Three veterans of litigation and claims involving "Defective Medical Devices and Insurance Exposures" introduced us to the future of claims involving not only hip, knee, and other transplants, but the growing world of prosthetics, implants, and nano-technology and the harm that can be done when these devices fail.

Rudy Dimmling, a Senior Director with Alvarez & Marsal's Insurance Advisory Services ("A&M"), and a veteran run-off and turnaround executive with Trenwick Re and Centre Group Holdings, led a panel discussion that included Christina Reisinger, also with A&M and a former risk manager with Cephalon, Inc. and Sanofi-Aventis, John Roberts, a Partner with Edwards Wildman in Chicago

and General Counsel to several durable medical equipment suppliers and surgical centers, and Ellen Relkin, a Partner at Weitz & Luxenberg, and former co-lead Counsel on the DePuy MDL litigation and a member of several committees for hip implant products liability litigation (the "Panel").

Ms. Reisinger led off with a statistical overview of these medical devices, their definition, and growing use. For example, in the U.S., artificial knees are becoming the most commonly implanted medical device and were the most frequently inserted device in 2012. Ear tubes lead the pack with respect to the total number of medical devices in use today, but only by a slim margin over implantable cardiovascular devices, pacemakers, artificial hips, spinal screws, breast implants, IUDs and coronary stents.

The Panel traded views with respect to the role of the Food and Drug Administration ("FDA") in approving and recalling these devices. The Panel pointed out the difference between clinical trials for drugs, which may begin with laboratory trials, animal testing, and then controlled tests with human



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## Educational Summaries / New York (continued)

subjects and FDA approval for medical devices, which cannot be tested on humans under laboratory-like conditions. Or, as Ms. Relkin put it, when it comes to sophisticated medical devices, the “customer is the guinea pig.”

Speaking from the plaintiff’s perspective, Ms. Relkin provided graphic photographic evidence of the damage caused by certain metal-on-metal hip replacements and the cobalt/chromium toxic tissue damage caused by some of these devices, including fretting and corrosion of the device itself. Ms. Relkin and her co-panelists also discussed the relationship between medical device manufacturers and the doctors who insert these devices. For the most part, manufacturers choose not to proceed against hospitals and physicians – their customers. (None of the 1,000+ actions now managed by the Weitz firm involve suits or third-party claims against treating physicians.)

Mr. Roberts outlined the most frequently asserted causes of action and the most common defenses. Plaintiffs usually rely on: (1) strict liability; (2) negligence; (3) consumer fraud; (4) common law fraud; (5) failure to monitor; (6) failure to warn; and (7) breach of warranty. Defenses to these allegations include: (1) contributory negligence; (2) federal preemption (express and implied); (3) the learned intermediary doctrine (the treating physician’s failure to advise); (4) assumption of risk; (5) lack of standing; and, (6) where available, Restatement of Torts defenses based on the lack of any better design alternatives for the device.

With respect to issues to be confronted in the future, the Panel alluded to the potential for insurer subrogation against the successful plaintiff and the efforts by organizations such as Broadspire to manage and treat claims from patients suffering from defective medical devices. The Panel also touched on the difficulty and cost incurred in removing defective medical devices.

Ms. Reisinger and Mr. Dimmling brought the discussion to a close with a look at the future, specifically the growing use of medical devices that now feature nano-technology and synthetic tissues. Defective medical device claims are quickly becoming the new frontier that experienced run-off managers will have to address. ●

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## News & Events

### Regulatory News

#### NYDFS Raises Requirements for Private Equity Firm Acquisition of Annuity Book



Expressing concern with private equity firms focusing on short term gains over policyholder protection, the New

York Department of Financial Services has approved the \$1.35 billion acquisition of Sun Life Insurance and Annuity Company of New York by private equity firm Guggenheim Partners, but only after Guggenheim Partners agreed to enhanced “policyholder safeguards” including 1. Greater capital requirements; 2. A backstop Trust Account; 3. Enhanced regulatory scrutiny of operations, dividends, investments and reinsurance; and 4. Stronger disclosure and transparency requirements. These tougher disclosure and capital requirements are significantly greater than those required in traditional insurance acquisitions, and may significantly affect the NYDFS’s recently announced review of the proposed bid by Athene Holding Ltd., an affiliate of the private equity firm Apollo Global Management L.L.C., to acquire the US book of annuity business of the British firm, Aviva P.L.C. for \$1.55 billion.

#### NAIC Financial Condition (E) Committee Approves Captive & SPV White Paper

On July 17th, the Financial Condition (E) Committee of the NAIC approved the white paper on the use of captives and special purpose vehicles and their effect on reserves of US life insurers (the “perceived reserve redundancies”). The White Paper discusses the background of Captives and SPVs and made specific recommendations for further study in a number of areas, including among other topics 1. Accounting considerations to address the perceived reserve redundancies; 2. Addressing the need for stricter rules on confidentiality and recommend uniformity among the states; 3. Recommending further study to ensure that the requirements for security provide the protections required under the Credit for Reinsurance Model Act; 4. Recommending enhanced disclosure of transactions in financial statements; and 5. Recommending development of guidance in the Financial Analysis Handbook to assist states’ review and analysis of transactions with captives and SPV’s.

### Industry News

#### R&Q to Acquire Run-Off book from Finnish Company Turva

Randall & Quilter Investment Holdings plc (“R&Q”) announced that it has successfully agreed a Portfolio Transfer

Plan with the Finnish mutual insurer Turva (“Turva”). The transaction is expected to be completed in September. Under the plan, Alma Insurance Company Ltd, a wholly owned subsidiary of R&Q in Finland, has accepted a portfolio of run-off reinsurance contracts underwritten by Turva through Vara-Pooli. Turva will transfer assets of €485,000 to cover the expected insurance liabilities and the expenses of the transfer, allowing Turva to exit its participation in the pool.

#### XL and Stone Point Form New Bermuda Management Company

XL Group (“XL”) and private equity firm Stone Point Capital LLC (“Stone Point”) recently announced the formation of a new Bermuda-based company to act as an investment manager in insurance-linked securities (ILS) and other reinsurance capital markets products. XL has a 75% ownership stake in the company and funds managed by Stone Point have the remaining 25% ownership. The XL Group announcement of this venture stated that: “When operations are fully commenced, the focus of the company will be on ILS and index-linked products as well as on XL-designed reinsurance products. The parties intend to invest up to an aggregate of \$135 million in funds to be formed, alongside potential third party investors.”

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## Enstar Acquisitions



**Atrium and Arden Re:** Enstar Group Limited (Enstar) announced in June that it has entered into definitive agreements with Arden Holdings Limited under which Enstar will acquire Atrium Underwriting Group Limited for approximately \$183.0 million and Arden Reinsurance Company Limited for approximately \$79.6 million. Atrium is an underwriting business at Lloyd's of London, which manages Syndicate 609 and provides approximately one quarter of the syndicate's capital. Arden Reinsurance is a Bermuda-based reinsurance company that provides reinsurance to Atrium and is currently in the process of running off certain other discontinued businesses. Both transactions are expected to close by the end of the fourth quarter of 2013.



**Torus:** In July Enstar announced that it has entered into a definitive agreement to acquire global specialty insurer Torus Insurance Holdings Limited ("Torus"). Torus is the holding company of six wholly owned insurance vehicles, including one Lloyd's syndicate. The total consideration for the transaction is \$692 million. Following the closing of the transaction, Enstar will own 60% of Torus and Stone Point will own 40%. The transaction is expected to close by the end of the year.

Enstar also announced that affiliates of Stone Point Capital LLC have committed to provide equity capital investments in Enstar's previously announced acquisitions of Atrium Underwriting Group and Arden Reinsurance Company. Assuming both of those transactions are consummated, Enstar would own 60% of those companies and Stone Point would own 40%.

## People on the Move

**Frank J. DeMento** has been appointed Of Counsel to the insurance/reinsurance group at the national law firm, Crowell & Moring LLP.

## Lloyd's CEO Richard Ward to Resign



After almost eight years in the role, **Richard Ward** has announced his intention to resign as CEO of Lloyd's

at the end of December. His decision was announced in July by the Council of Lloyd's, which together with the Lloyd's Franchise Board will conduct a process with a view to the appointment of a successor before the end of the year. Dr. Ward has been Lloyd's longest-serving CEO. ●

## IN MEMORIAM

**Sol Kroll**, legendary insurance lawyer for over 71 years, died in July at the age of 94. Sol was a pioneer in transnational legal circles, and was the first US General Counsel to the Institute of London Underwriters. Sol was also noted for having hosted the opening cocktail party at the annual Rendez-vous de Septembre reinsurance conference in Monte Carlo for over 30 years.

Fall 2013

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**October 13-16, 2013**

AIRROC Commutation and  
Networking Event  
East Rutherford, NJ  
[www.airroc.org](http://www.airroc.org)

**October 16-19, 2013**

IAIS (International Association  
of Insurance Supervisors)  
20th Annual Conference  
Taipei China  
[www.iaisweb.org](http://www.iaisweb.org)

**December 15 - 18, 2013**

NAIC Winter National Meeting  
(Includes IAIR Issues  
Forum and Reception)  
Washington, DC  
[www.naic.org](http://www.naic.org)

If you are aware of items that may qualify for the next "Present Value," such as upcoming events, comments or developments that have, or could impact our membership, please email Fran Semaya at [flsemaya@gmail.com](mailto:flsemaya@gmail.com) or Peter Bickford at [pbickford@pbnylaw.com](mailto:pbickford@pbnylaw.com).



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## Rendez-Vous

# New Jersey 13 - 16 October 2013

A nighttime photograph of the Manhattan Bridge in New York City, illuminated with warm lights. In the foreground, several people in business attire are silhouetted against the bridge and city lights, appearing to be in conversation.

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