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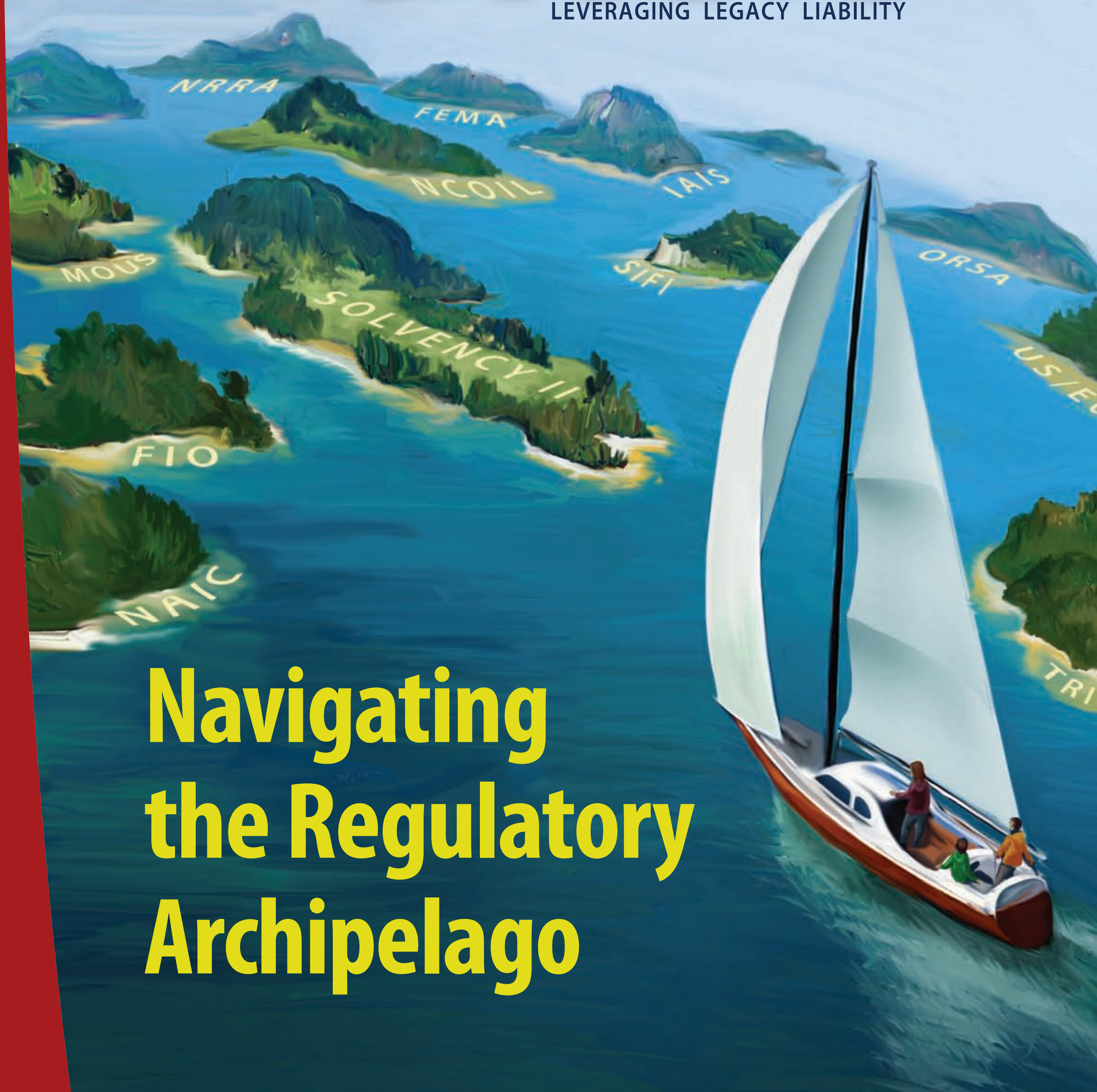
AIRROC matters

LEVERAGING LEGACY LIABILITY



Navigating the Regulatory Archipelago

COMMISSIONERS SPEAK OUT • SOLVENCY "II" SLOW? • CELL PHONE LIABILITY • (SEMI) CONFIDENTIAL ARBITRATION AWARD • NEW YORK'S BI-ECONOMY DECISION

KPMG
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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(AIR)ROC the House!

Peter A. Scarpato

AIRROC's reputation for excellence in the field of legacy/runoff management continues to grow. We are "rockin' the house" in ways that AIRROC's founders could not imagine. Our Publications Committee works hand-in-glove with AIRROC's Executive Director and the Board to investigate and report on all things helpful and relevant to our members. But we need your input, advice, and your thoughts for future ideas, articles, interviews and trends. Please contact me, co-editors Maryann Taylor and Jim Veach, Carolyn Fahey, or anyone on the Publications Committee – all ideas are welcome.

Now, our edition. Fran Semaya, Jim Veach and Fred Pomerantz captured a unique, incredibly insightful discussion with commissioners Tom Leonardi, Julie McPeak and Joseph Torti in *Navigating the Regulatory Archipelago*. The interview covered a broad range of topics, including the NAIC and FIO, Credit for Reinsurance, the GIA, Captive insurers and Accreditation, TRIA reauthorization… you get the idea. The group also discussed fallout and feedback from states' reactions to Super Storm Sandy. Next, in *Solvency "II" Slow,* George Belcher of Reynolds Porter Chamberlain elicits the perspective of Rene Dubois, Head of Business Advisory at Liberty Syndicates, on the now somewhat infamous, sluggish pace of Solvency II's implementation.

Our new section, entitled Emerging Issues, includes *Call Me…Maybe?* Molly McGinnis Stine and Julie Johnston's exploration of potential cell phone liability and related insurance coverage issues. Is that device in your pocket a timesaver, or time bomb?

Our AIRROC Toolbox, ever-brimming with shiny new tools, offers up two helpful articles: the first, in *Follow-the-Settlements: Transparency and the Attorney-Client Privilege*, Jennifer Devery and Christie Mizer offer advice on steps necessary to broaden protection of the attorney-client privilege to include confidential documents presented to reinsurers, and sought by policyholders. Next, Michael Olsan and Brendan McQuiggan "peek behind the curtain" of *The New (semi) Confidential Arbitration Award,* offering disputants suggestions, including revising the "standard" confidentiality agreements to guard against the courts' emerging preference to disclose otherwise protected information.

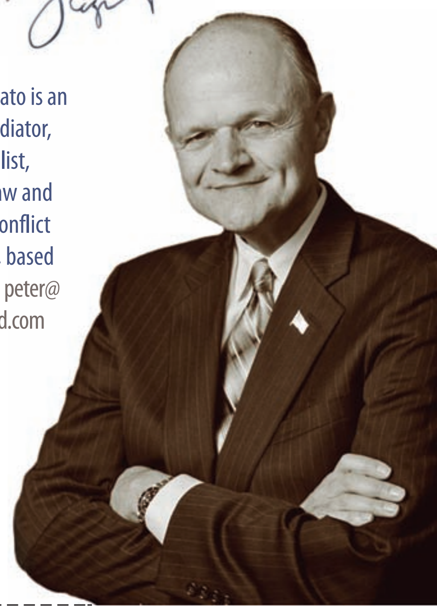
In our Legalese section, R. Steven Anderson and Kyle M. Medley weather the *Tempest in a Teapot*, in their analysis and historical perspective of two 2008 decisions from New York's highest court: Bi-Economy Market vs. Harleysville Insurance Company. At the time, people expected that these decisions would change the legal landscape by recognizing an insured's right to consequential damages beyond policy limits for an insurer's bad faith claims handling. In fact, the true impact was minimal. Indeed, subsequent courts have clamped down on the possibility of an overexpansion of New York law in response to these decisions. What lurks in the future is eventual cession of such consequential damages to reinsurers, and the debate over whether these damages are covered by the treaties' ECO clause.

In addition to our usual Present Value, the AIRROC Update section includes Carolyn Fahey's Lions and Cheetahs (oh my!), an update on all AIRROC events and Ed Gibney's summary of our upcoming, exciting 9th Annual Commutation and Networking Event at the newly renovated Sheraton Meadowlands Hotel and Conference Center on October 13-16, 2013.

Ever-changing, ever-growing, ever-rockin'!

Let us hear from you.

Peter A. Scarpato is an arbitrator, mediator, run-off specialist, attorney-at-law and President of Conflict Resolved, LLC, based in Yardley, PA. peter@conflictresolved.com



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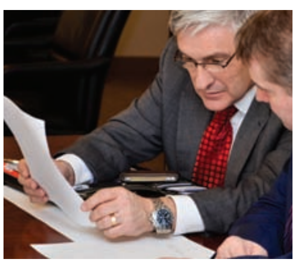
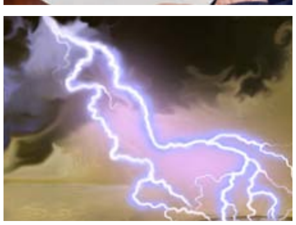
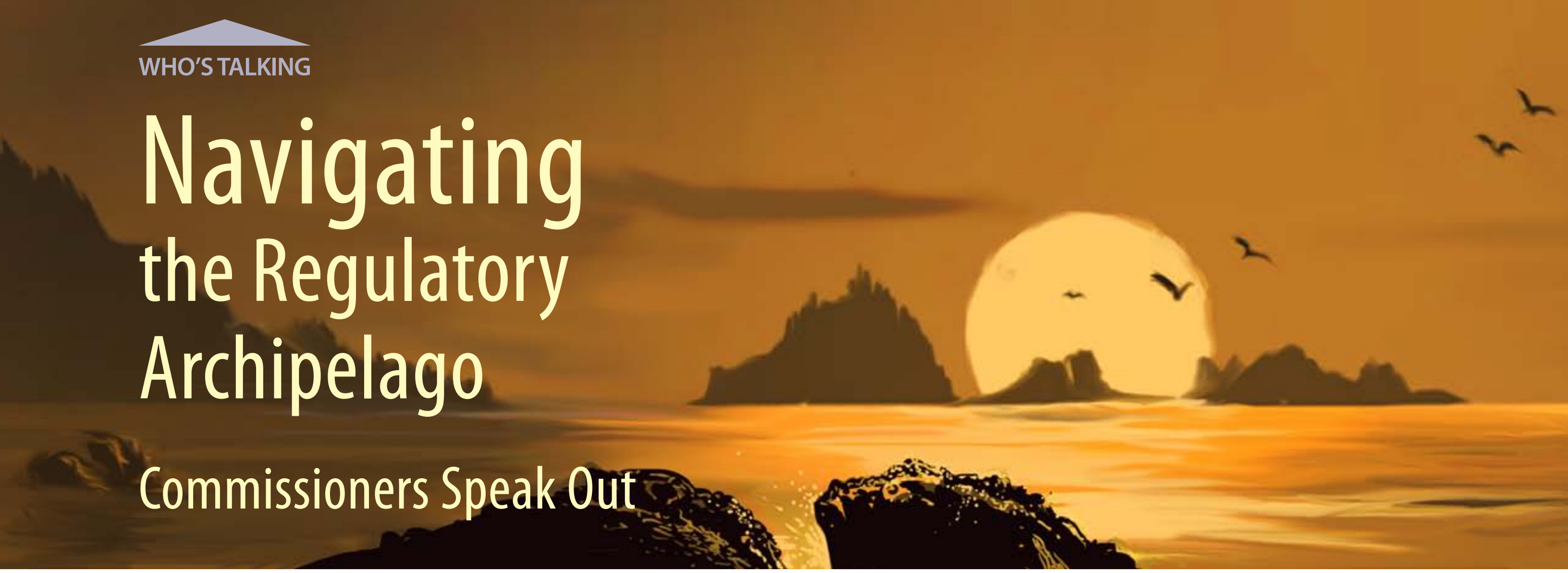




Illustrations / Rafael Edwards
Photos / Jean-Marc Grambert



Navigating the Regulatory Archipelago

Commissioners Speak Out

Moderators Fred Pomerantz, Francine Semaya and James Veach interviewed Commissioner Thomas Leonardi (CT), Commissioner Julie McPeak (TN), and Superintendent Joseph Torti (RI) to discuss several key regulatory matters.

The NAIC and the FIO

Francine Semaya: *Two questions. First, how does Senator Ben Nelson's appointment as the National Association of Insurance Commissioners' (NAIC) CEO impact the NAIC's ongoing relationship with the Federal Insurance Office (FIO)? Second, what does the NAIC understand to be the FIO's role in regulating the "business of insurance"?*

Leonardi: FIO is not a regulator and cannot speak for the states. The Director has the voice of the federal government while state insurance commissioners, acting through their standard setting organization, the NAIC are the voice of U.S. Regulators. While FIO has an important role in the international arena, we must keep in mind that the state-based system has done very well protecting policyholders and consumers. During the economic crisis, policyholders fared very well.

The NAIC believes that Senator Ben Nelson, its new CEO, is a sensational selection. Ben has contacts in Washington including his former colleagues in Congress and in the White House.

McPeak: Senator Nelson will enhance NAIC's relationship with the FIO. He has tremendous presence in Washington, DC and will be very effective.

Semaya: *What will be the most notable or revolutionary recommendation in the FIO's long overdue report to Congress on modernizing and improving the regulation of insurance?*

Leonardi: I hesitate to speculate. If the Report was written 13 months ago and has been sitting on a shelf, it would not be as relevant today.

Torti: No inside information on what the Report will say.

NAIC 2013 Initiatives

Semaya: *What are the NAIC's most important topics in 2013?*

McPeak: The highest priority in life insurance is principles-based reserving. The NAIC has created a PBR implementation task force to focus on state resources, legislative support and the use of captives as a tool for reserve relief, among other issues.

Torti: In addition to the work implementing principles-based reserving, implementation of the credit for reinsurance standards by the Reinsurance Task Force will be crucial.

Leonardi: Internationally, the first big item, in my opinion, is the systemic risk issue and the G-SIFI process, which should come to a head this summer with respect to whether any companies will be deemed globally systemically important.

The second big item is ComFrame, the "Common Framework for the Regulation of Internationally Active Insurers". The IAIS has collected numerous observer comments, most recently in New Orleans, with respect to ComFrame. We have a March meeting in Basel, Switzerland that will give the industry an opportunity to further comment on the proposals.

Another big item is the US/EU dialogue project. Last Fall's NAIC report on the US/EU dialogue was well received. There are plans to continue to work with the EU on Credit for Reinsurance and group capital, group supervision, confidentiality, and other issues. We want to move from issues of equivalence to what EU regulators do, what we do here in the U.S., how the regulatory systems are similar, how they differ, and what outcomes are achieved.

While FIO has an important role in the international arena, we must keep in mind that the state-based system has done very well protecting policyholders and consumers.

Not specific to international issues but equally important is the NAIC's newly-created task force at the Executive Committee level on financial stability, which I'll be chairing and Superintendent Lawsky will be vice-chairing. This task force will analyze systemic risk and how the NAIC and state regulators view, deal with, and work through this issue as an ongoing matter and not just a current snapshot of who may or may not be systemic.

As to health care, the NAIC will address the health insurance rollout. We have some states not doing exchanges or

Moderated by Fred Pomerantz, Francine Semaya & James Veach

illustration / Rafael Edwards

doing exchanges in different ways. This translates into an awful lot of work on the B Committee's plate, which Commissioner Praeger (Kansas) is chairing.

Commissioner Chaney (Mississippi) and the C Committee will address issues surrounding the recent Northeast storms and catastrophe risks throughout the U.S. The D Committee under Commissioner Sharon Clark is pushing forward with important issues on market conduct and agents and brokers. The F Committee continues its work to strengthen our accreditation program and to assist states that need it or would like to avail themselves of other states' expertise.

Credit for Reinsurance Amendments

Semaya: *Regarding the NAIC's Credit for Reinsurance Task Force, what is the NAIC doing to ensure that states adopt the amendments made to the Model Act and regulation to ensure that reinsurers, especially non-U.S. reinsurers, are treated equally throughout the United States?*

Leonardi: The NAIC passed the credit for reinsurance model law unanimously in November 2011. Now, as with any Model Act, the state commissioners must go back, introduce legislation, and get it passed and signed by their governors. The NAIC has little control over that part of the process and probably should not. Twelve states have implemented statutes or regulations either prior or subsequent to the Model Act's adoption. Those states represent about 60% of the US reinsurance business.

When one considers the number of states that have adopted the model — 12 versus

We have many significant models coming through the NAIC. Simultaneously, we need to ask legislators to consider things like PBR, ORSA and Credit for Reinsurance models.

– Julie McPeak

56 jurisdictions — it may not seem like a lot, but there has been substantial progress in those states with the most reinsurance and particularly foreign reinsurance where this issue comes into play.

Torti: In Rhode Island we worked effectively with legislators on these models. In addition, all states were invited to the NAIC Fall Meeting where there was much discussion on the Credit for Reinsurance models and the need to pass them in all states. State legislatures should be very familiar with the models by now and I think this is one of those models that will enacted quickly.

About a dozen states have already adopted the model law. Without it, the industry in your state operates at a competitive disadvantage. So there's a real incentive to get it moving. I don't have the exact number, but I understand that the vast majority of states are putting it in their legislative package this year.

McPeak: We have many significant models coming through the NAIC. Simultaneously, we need to ask legislators to consider things like PBR, ORSA and Credit for Reinsurance models. Each one is meaty and important and we have to make those individual decisions within our states regarding timing of legislative initiatives. State commissioners want to pursue these models but at the same time we have to carefully manage that process and timing.

Torti: That's a great point, Julie. Those three model laws are extremely important. In fact, we are considering all three models in Rhode Island. In addition, some states are looking at the Holding Company Model Act.

Fred Pomerantz: *We all know that the NAIC Model Law on Credit for Reinsurance requires states to consider the NAIC's list of "qualified jurisdictions" to evaluate whether a non-U.S. jurisdiction should be recognized as "qualified" for reduced collateral purposes. The industry provided much feedback on this, including the General Insurance Association (GIA) of Japan, which on January 28, advised the NAIC's Reinsurance (E) Task Force that the process of evaluating "certified reinsurers" and "qualified jurisdictions" as stipulated in the new guidelines adopted during the*

Navigating the Regulatory Archipelago (continued)

Fall National Meeting is "unreasonable" and constitutes "double jeopardy".

Do any of you agree or disagree?

Torti: The GIA has taken the same position since the beginning of our discussions on reinsurance collateral. I don't understand the reference to "double jeopardy." That is not the case. The NAIC has an accreditation program and we still look at insurers domiciled in other states, even though the accreditation program exists, and we honor the sovereign regulation of other states.

In our Financial Analysis Working Group, we identify companies all the time. We work together as regulators to address issues at those companies, despite the fact that a company is domiciled in an accredited jurisdiction. We also have an analyst team system which identifies companies as soon as their annual statements are filed to help states identify the priorities they should give to their companies.

This isn't unusual. Our Credit for Reinsurance Model requires that we qualify jurisdictions and also that insurers be certified and rated. The company's rating determines the amount of collateral relief given. Simply by qualifying a jurisdiction, we could not fulfill the Model's requirements.

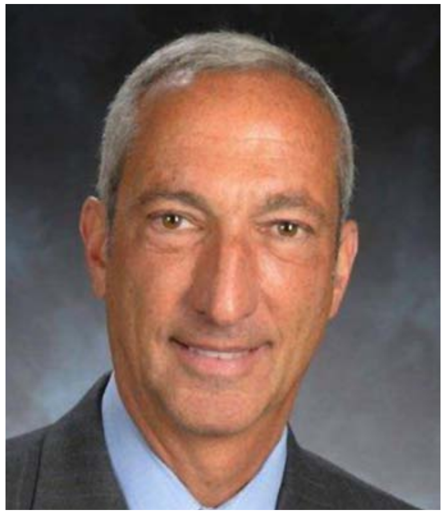
I completely disagree, therefore, with GIA's comments. Our actions through the NAIC on credit for reinsurance standards as they relate to international reinsurers and jurisdictions are no different than what we do among ourselves in the states.

Captive Insurers and Accreditation

Pomerantz: *Do you believe that a captive should be eligible for accreditation on the same basis as a traditional insurer?*

Torti: The accreditation program is a system to accredit states, not reinsurers. So the question is whether we include captive insurers in the accreditation program to determine if a state should be accredited, right?

Pomerantz: *Yes.*



The facts bear out Governor Christie's criticisms – the National Flood Program has fallen way behind the insurance industry.

– Thomas Leonardi

Torti: We are considering that now. Captives are included in the accreditation program. Risk retention groups that are chartered as captives, are included in the accreditation program, and there are laws, regulations and standards that apply to them as well.

Captives excluded from the program are mostly single state self-insurance captives. There is no present intention to include those types of entities in the accreditation program. The captives that we are likely to include are those that reinsure entities within their holding company structure. The Principles Based Reserving Implementation Task Force is looking at that issue.

So it is possible that jurisdictions regulating those types of captives could be held to current or new standards included in the accreditation program going forward.

NRRA – Surplus Lines

Pomerantz: *Because most states have failed to adopt either of the two competing surplus lines premium tax allocation agreements, NIMA or SLIMPACT-Lite, and the states most often deemed the "home states" for multi-state risk policies appear content to retain 100% of surplus lines premium taxes collected on those policies, how has the NRRA meaningfully promoted uniform regulation of the surplus lines industry, particularly equitable tax allocation among states?*

Torti: Rhode Island is a SLIMPACT state. We have a strong NCOIL presence in Rhode Island and a few years ago Rhode Island enacted SLIMPACT. To date, nine states have adopted SLIMPACT. Ten states are required for full implementation. For that reason little progress has been made in formulating and adopting an interstate compact or other agreement to share premium tax.

The way NRRA works is somewhat problematic and it's been very difficult for the states to formulate a solution, given the limited options available.

McPeak: I don't view the NRRA's primary goal as equitable tax distribution. It was an industry-sponsored bill to ease the continuation of surplus lines business by the brokers and companies. The bill was written to make the system more efficient, not really to focus as much on equitable tax distribution -- that was left to the states. And we ended up with competing models.

But the NRRA does create a standardized tax rate, making the transaction of surplus lines business more efficient. The NRRA also adds efficiency to the industry because surplus lines brokers will not have to file a tax return for the multi-jurisdictional risks in every state. But, the equitable distribution of taxes is something that we continue to work on.

Super Storm Sandy

James Veach: *A few questions about Super Storm Sandy. Sandy affected approximately 24 states. Did it hit Tennessee, Commissioner McPeak?*

McPeak: No.

Navigating the Regulatory Archipelago (continued)

Veach: *For our regulators in Rhode Island and Connecticut, two questions. First, did insurers respond well to Sandy? Second, New Jersey Governor Christie recently said, based on his experience with FEMA and the National Flood Program during Sandy, that the National Flood program is a "disgrace." Do you agree?*

Leonardi: I do believe insurers did extremely well handling Sandy claims in Connecticut. The last time I looked, 85% of claims from Connecticut claimants were paid and closed. I think this is true in New Jersey and New York as well. And yet, only about 17% of National Flood Insurance Program claims have been processed and paid in that same period.

Frankly, that disparity is astounding. The facts bear out Governor Christie's criticisms – the National Flood Program has fallen way behind the insurance industry.

This is a great example of how a state-based insurance regulatory system with high quality insurance companies doing their best to fulfill the promises they made when they accept premium is the best answer to the question: "why not have the Federal government regulate insurance?" Insurance companies have done a terrific job responding to Sandy. NFIP has not.

Torti: We've had a similar experience in Rhode Island. The insurance industry did a great job responding to claims. We expected tons of complaints after Sandy, but they never materialized. We received only a handful of calls and complaints.

We established an emergency adjuster process in Rhode Island and quickly approved companies' bringing in adjusters from all over the country. There have been few, if any, issues with the response to, or treatment of, policyholders and claimants in Rhode Island.

There were some issues with respect to FEMA and flood claims and having enough FEMA adjusters. But I can't say more about the quality of the industry in responding to this storm.

As to state regulation of insurance, we have an ad hoc group of state regulators in the Northeast Zone that deals with catastrophes and catastrophe preparedness. We share our experiences, bulletins, regulations, and statutes. We try to ensure that, to the extent possible, we act uniformly throughout the Northeast Zone.

As a result of events in the South, we were better prepared in Rhode Island for both Irene and Sandy. I think that's going to happen in some states as a result of Sandy and that brings more certainty to the industry.

–Joseph Torti

State regulators in the Northeast Zone also included industry representatives in our calls regarding Super Storm Sandy. As a result, shortly after Sandy, the industry was able to express their concerns to states impacted by Sandy. I think this unified approach worked very well.

Leonardi: Yes, I concur. You learn something every time you go through one of these. It would be nice for other states to learn from our experience because we in the Northeast have had our fair share of storms and floods over the last two years. Commissioner Torti's Department, in particular, has taken a substantial lead bringing other departments and their different resources together and - in that narrow respect – Sandy has been a fantastic learning experience.

McPeak: I can't address Super Storm Sandy, but one strength of the state-based regulatory system is that we each have unique experiences which we can, and do, share. For example, insurance regulators in the Southeast can help regulators in the Northeast with flood, hurricane and wind data collection. It's common for our regulatory colleagues in other states to obtain and offer assistance to other state departments.

If Rhode Island, Connecticut or New Jersey needs some additional consumer service assistance we would loan people from our department. It's a system that previously worked very well because we support one another in times of need.

Veach: *In New York and New Jersey, and perhaps Rhode Island as well, Sandy sparked a flurry of emergency orders. In New York, for example, the Department of Financial Services issued a Circular Letter and amended regulations changing how insurers inspect damaged property and adjust losses. In New York, there is pending legislation which proposes, for example, a consumer bill of rights for catastrophe coverage and a no-hurricane-deductible homeowner's policy.*

Did any good ideas emerge from the emergency response to Sandy or are these largely political measures adding little long-term value to state insurance regulation?

Leonardi: I can't discuss legislation that may be enacted in other states. But from Connecticut's perspective, we've learned a lot. When tropical storm Irene came through, we confronted a hurricane deductible issue that arose under a 2007 or 2008 Bulletin. In short, if the National Weather Service declared a hurricane warning in Connecticut, the deductibles on some policies applied, whether the hurricane made landfall or not.. For some reason, the Bulletin's language did not require that there also be sustained hurricane force winds in the state.

Hurricane Irene did not produce hurricane force winds in Connecticut. I don't think there were even hurricane force gusts, let alone sustained winds.

In the aftermath, we thought: "this just doesn't seem right." Policies filed in Rhode Island, New Jersey, and New York had other language and those states required a hurricane for the hurricane deductible to apply. Insurers assumed risks and collected premium on that basis and for that particular risk.

So the Governor and I asked insurers to waive their deductibles. Of the ten target companies, four came to us right away and said: "this is not what was intended and we're not going to apply the deductible. We're going to waive it." Several companies – I think three – said: "even though the Bulletins don't say it, the language in our contracts requires that there be at least hurricane force winds, category one or better." Some actually required a category three.

Only one company enforced its policies' deductibles, even without a hurricane. We didn't try to say, "You can't." We asked companies to do the right thing and I thought the response was very good. We immediately changed the Bulletin. We used language very close to Rhode Island's wording because that's what I thought was the best wording available. That wording and those deductibles were then in place for Sandy. In the next Connecticut legislative session in 2012, our legislature passed an act that basically codified our amended Bulletin.

Part of your question is whether we create economic and underwriting problems for insurers and reduce the certainty that companies need when we change things after the fact. I agree that we should not change things after the fact and I hold that with tropical storm Irene we weren't trying to change something – we were trying to say: "This was just a mistake and everybody knows it's a mistake." That nine of our top ten companies agreed with us suggests to me that we weren't strong-arming, and we weren't changing things after the fact.

Torti: As horrible as these events are, from a regulatory perspective, we learn a lot from them. After Katrina and Rita, we started to look at issues for the Northeast because obviously we recognized we would be affected by the fallout from the next storm.

Absent private market solutions, sustaining a viable market for terrorism insurance really does depend on a federal backstop.

In Rhode Island we began to look at hurricane deductibles, wind deductibles, and other issues. Before Sandy, we were fortunate to have addressed hurricane-related issues in Rhode Island with legislation that required a dual trigger – both a hurricane warning and sustained hurricane force winds in the state – for hurricane deductibles to apply.

As a result of events in the South, we were better prepared in Rhode Island for both Irene and Sandy. I think that's going to happen in some states as a result of Sandy and that brings more certainty to the industry. Insurers may not like the legislation that gets passed or the positions taken by the various departments, but at least at that point they know how to underwrite their business. They will know what they're facing in a given state.

Terrorism Risk Insurance Act Reauthorization

Semaya: *Let's turn to the Terrorism Risk Insurance Act. Legislation has just been introduced in the House by two New York representatives, one a Republican and one a Democrat, proposing to extend the current TRIA Reauthorization Act until 2019. The insurance industry fully supports TRIA's reauthorization. However, certain groups feel that the federal backstop is no longer necessary, and that 9/11 happened long ago. What will regulators, or the NAIC, do to ensure that TRIA is reauthorized and how should we get it passed?*

Leonardi: Absent private market solutions, sustaining a viable market for terrorism insurance really does depend on a federal backstop. The NAIC through the C Committee has a working group dedicated to the terrorism insurance implementation and is trying to coordinate all of our various efforts regarding TRIA.

Torti: I don't know what will happen to the commercial lending market without a federal backstop or private insurers willing to write terrorism risks. I guess some entities will be considered in default on their loans on certain properties.

So I'm not sure that we can go without the federal backstop. I think something will eventually need to be done.

Semaya: *Being in lower Manhattan at the very moment and having been here on 9/11, we all are very concerned about TRIA's reauthorization, especially in its current state. If there are going to be changes, what changes would be acceptable to you, as regulators, so the industry can continue issuing its commercial insurance policies and reinsurers will continue to reinsure these covers? The reinsurance market is saying that they will stop reinsuring terrorism insurance for the commercial markets without a federal TRIA backstop.*

Leonardi: Yes, we've heard the same thing. That's why I think, absent a private market solution - and I don't see one being proposed by anybody - we need the federal backstop. And that's why Joe was saying that we think it's going to be important or else we're going to have a big disaster- it's not going to just affect New York City -- it's going to affect the whole country.

Captive Insurers

Veach: Since each of your states *have captive programs and are pushing captive formation in your states, is the argument valid that states and state regulators competing for captive business will eventually produce a regulatory race to the bottom?*

McPeak: I don't think states are competing for domestic captive insurers on the basis of less regulatory oversight. There are things you can do to make the market

Navigating the Regulatory Archipelago (continued)

more attractive, in terms of taxes and filing flexibility, but I feel comfortable that each state takes its responsibility for the oversight of its captive insurers very seriously.

The purest forms of captives are true self-insurance with more regulatory oversight than actual self-insurance. You find an additional layer of regulatory and insolvency monitoring just in the creation of a captive insurer. To the extent states are competing for domestic captives, I don't think it's creating a race to the bottom in terms of regulatory oversight, I think the exact opposite is occurring.

Torti: I think you're right. Rhode Island has not recently tried to promote its captive industry. We have a statute that's very similar to Vermont's captive statute and we did cut our tax rates in half at one point to compete with Vermont, but that was in the late '90s. As a result, we got some captives and we also got some applications from entities that had some unusual ideas and business plans, to say the least. Despite our trying to bring captives to Rhode Island, we did not accept those applications.

I don't think you will see a race to the bottom where states just lower their regulatory standards to compete. For captives, the competition will occur with lower taxes or in some other way, but not through reduced regulatory standards.

Leonardi: I agree with both Commissioners.

Veach: *I saw some January press releases from Delaware, Vermont, and other state insurance departments setting out the number of new captives formed in those states. Where is captive growth coming from and where will it come from in the future? Can captives be used to provide a layer of terrorism risk protection?*

McPeak: The growth that we experienced in Tennessee came almost entirely on the healthcare side. Large corporations want to manage the risk associated with providing health care for their employees and retirees and a captive may serve as a vehicle to maintain certain levels of coverage. We don't see captives providing coverage on TRIA-type risks, but we do see lots of pure captives in Tennessee used to manage their owners' regular liabilities -- fleet management, property management, and things of that nature.

The purest forms of captives are true self-insurance with more regulatory oversight than actual self-insurance.

Captives and Run-Offs

Veach: *Do you see any role for AIRROC and the run-off industry in the captive arena, especially as to captives that no longer serve their original purposes and are dormant, or troubled? Should run-off investors or managers be invited to assist with a troubled captive?*

Leonardi: Many captives, if they're not run by their owners, have captive managers who are presumably responsible for the run-off. I'm not familiar with any troubled captives but perhaps Commissioner Torti is.

Torti: We have some special run-off statutes in Rhode Island. And we have companies that look to purchase run-off companies. These run-off specialists are very efficient at running these companies and running off these books of business.

I don't see why we couldn't use those same companies to help out with captives in run-off. An entity that specializes in run-off may more efficiently complete a run-off than would a straight captive manager or the company that owns the captive.

We see potential for growth in this area, but I don't know the number of captives in run-off. It would be interesting to look at those numbers.

Solvent Run-Off Statutes

Pomerantz: *Joe, with Rhode Island being the only state with a solvent run-off statute, why haven't other states adopted similar statutes? Also, how has that statute impacted Rhode Island's insurance industry in particular?.*

Torti: We've only had one company that's gone through the solvent run-off process and it was a reinsurance company. When the company's run-off plan was challenged, the court upheld it. The problem is that the law has limited application; It cannot be used by a personal lines or a life insurance company. It only applies to a commercial insurer or reinsurer in run-off. So there's a small universe of companies that qualify to use the statute.

A couple of states have shown interest – Vermont might be one – and there is still potential for growth. We urged adoption of this legislation in Rhode Island because we saw how insurance industry runoff has worked and said, "Well, there has to be another way to do this other than running off a company for 40 years. There has to be another way to do this a little more efficiently, to get all the policyholders paid off and to come to an agreement with the creditors and close out the company's runoff obligations in six or seven years, instead of 30 or 40 years."

While it's still a great idea to do it, there are complications in doing it. As a regulator you need to think long and hard before you do something like this because there are policyholder protections to keep in mind. The role of the insurance department under this law is primarily policyholder and claimant protection.

Memoranda of Understanding

Semaya: *With the establishment of FIO as the United State's voice in international matters, what, if any, memoranda of understanding should states be allowed to execute with other countries?*

Previously states like New York have entered into MOUs and I believe several other states have and continue to do so. An issue raised is whether states are authorized to enter into MOU's with foreign countries now that FIO exists?

Navigating the Regulatory Archipelago (continued)

Leonardi: What FIO does is represent the federal government. It is not an insurance regulator. You're dealing with confidential information in terms of supervisory colleges, which is the biggest and most important tool in group supervision for these large companies. You have memoranda that each college usually has where you're negotiating as the lead regulator with all of the different countries and other state jurisdictions that are involved in that college. And FIO has nothing to do with this. You can't have a college without being able to protect this very confidential information so that you can share it, because if you can't share it the regulators can't collaborate and coordinate their efforts, which is the goal.

…it's important for the U.S. and the EU regulators to communicate and collaborate on issues.

The role of FIO has nothing to do with states entering into MOUs. I certainly don't need FIO's permission to enter into an MOU with any jurisdiction, such as the MOUs Connecticut signed with Switzerland, Germany and the Netherlands. And the existence or creation of FIO doesn't affect my ability as a state regulator to effectively do what I need to do on the international or domestic front.

Connecticut was the first state to enter into the IAIS's multi-lateral-memorandum of understanding. We were the 21st signatory in the world to sign it. Washington has recently become the second state. I believe a third state is very close. Other states are working on it. As I just mentioned, in CT we have bilateral agreements with Switzerland, Germany and the Netherlands.

So, that's just part and parcel of what we do and FIO has no impact whatsoever on that.

Semaya: *Is there anything else that any of you would care to share with us at this time?*

IAIS and Solvency II

Leonardi: You had a point about Solvency II and the role of the IAIS generally in group solvency. The industry really cares about what's happening on systemic risk and on ComFrame. On the international side we're spending a lot of time focusing on that. Regarding Solvency II and equivalence, I pointed out many times since 2011 and the NAIC has done so in many instances previously that we aren't going to submit our system to equivalence with any regional framework. Nevertheless, it's important for the U.S. and the EU regulators to communicate and collaborate on issues. We oversee two-thirds of the global insurance market collectively and we share responsibility for a majority of the IAIG's out there.

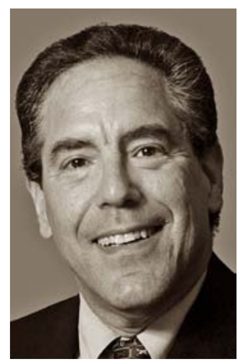
It's really important to keep that dialogue going. It's premature for us to judge the effectiveness or the value of Solvency II until the EU implements it and has some experience with it, in terms of both good times and bad times and times of stress. We cannot judge the appropriateness of Solvency II for Europe but I can say with certainty that it's not appropriate for the United States; we have fundamentally different governmental, regulatory and legal environments. We have different approaches to capital and group supervision. And as I've said before, our 150-year track record of protecting policyholders has weathered the worst financial crisis since the Great Depression. So our hope for Solvency II is that Europe can build a system that's comparable to that level of consumer protection that we have put in place.

The only other thing I'd like to add is the Model Holding Company Act that Joe mentioned earlier. It is an enormous step forward in our ability to do group supervision, for all the reasons associated with the ability to protect the confidentiality of data at the holding company, to be able to demand that information on any entity wherever the entity exists, whether it's an insurer or not, whether it's in the U.S. or not, and again, to protect the confidentiality of that information. The ability to effectively supervise colleges, to charge all the expenses associated with that, just like we do on financial exams, is a significant fact. These are major steps forward as part of the SMI.

The only other things you haven't asked about which should be considered and are not international necessarily, are longevity risk and the record low interest rates that we're dealing with, and the stress those things may be creating with companies' reserves.

Veach: *We certainly appreciate the time all three of you have given us and our readers. Thank you.*

Semaya: *Our many thanks for your participation. Have a good day.* ●



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Solvency "II" Slow?

illustration / Rafael Edwards

George Belcher Interviews Rene Dubois, Head of Business Advisory at Liberty Syndicates

Progress towards Solvency II's implementation has been hampered by delays and repeatedly missed timetables. Originally set for 1 November 2012, and delayed to 1 January 2014, all now acknowledge that even this timetable is not achievable. The industry is awash with speculation regarding what might happen next, ranging from total abandonment to full project implementation, although the consensus is that a variety of plans will be implemented by 2016 at the earliest.

The delays turn on the so-called "Omnibus II" directive, which is designed to amend the main framework text in certain key respects. Negotiations between the EU Parliament, the EU Commission and the EU Council have run into political deadlock in key areas, including the treatment of sovereign debt and long-term guarantees, and transitional periods. The EU Parliament is scheduled to discuss and hopefully agree to the Omnibus II text in October 2013; a date which has slipped repeatedly. This further delays finalisation of other legislative provisions which will contain substantial additional detail required to deliver the Solvency II project. This is compounded by further impact assessments in long-term guarantees and calibration of capital requirements for long-term insurer investments. It is not clear whether these reports will feed directly into the Omnibus II directive, producing yet more delays, or can be held over until finalisation of level 2 measures. In any event, these fundamental issues will go to the heart of the project, particularly for long-term insurers.

These delays have caused uncertainty, not least amongst the national EU regulators charged with implementing the final rules. The UK Financial Services Authority (which on 1 April 2013 handed its Solvency II responsibilities to the new Prudential Regulation Authority ("PRA")) has proposed a dual-track approach, whereby firms may implement elements of the new regime on a "shadow" basis alongside current requirements before the new regime goes into effect. For firms planning to use an internal model it, proposes to agree with each firm a "landing slot" in which it may switch to use of (and reliance on) that model at any date the firm chooses up to 31 December 2015. Whilst a pragmatic response to an unsatisfactory situation, the industry remains frustrated with progress, and costs incurred to date. This frustration extends to the PRA, where a senior figure has described Solvency II's costs – estimated to total at least £3bn (approximately US$ 4.5bn) for UK companies alone – as "shocking" and "indefensible".

In the following sections, Rene Dubois, Head of Business Advisory at Liberty Syndicates (the Lloyd's division of the Liberty Mutual group), discusses his perception of Solvency II from the industry perspective.

George Belcher: *How has this uncertainty affected the international insurance market, both in the EU and beyond?*

Rene Dubois: It is difficult to disagree with Solvency II's thrust – which was born of the late 1990's high profile financial failures. All other things being equal, embedded risk management and governance should reduce the potential for firms to fail. The quantitative measures causing technical difficulties in very unusual and testing economic times, are only part of a wider largely common sense "Pillar 2" framework whereby firms move to a system of articulating what they do in relation to their assumed responsibilities, and are then subjected to a sensible discussion and some challenge within supervisory review. In a complex financial world with changing financial dynamics it is hard for regulators to engage with firms in a mutually useful manner and, above all, to be forward looking – together.

Liberty Mutual includes UK firms. The prior and current UK regime went some way along similar approaches. Solvency II has certainly involved a step up. Within the Lloyd's syndicate, the new approaches have been project managed at significant but manageable cost and embraced, and are beginning to become genuinely part of general firm awareness in terms of decision making. Work is now focused on a refined analysis to optimise risk reward trade-offs – as an important part of staying ahead in markets where the "people" aspect can sometimes be responsible for decisions which cannot be rationally defended. In fact the "delay" in Solvency II implementation is almost salutary, allowing the firm to relax into studying what really works rather than leaving a perception of being forced into some kind of regulatory corset too quickly.

The large and internationally active Liberty Mutual group has a group ERM approach and is studying particular Solvency II modelling methodologies at the group level. There is a healthy dialogue between high qualified actuarial experts in a genuine effort to be smart about risk.

I believe Solvency II will be of ultimate net benefit to the industry. Unfortunately we must live through a phase of the Biblical Seven Lean Years, so the most intellectually rigorous features and rigid applications have been postponed. In doing so, regulators have intuitively recognised that regulation does not exist for its own sake but is an instrument of policy which ultimately – just like the financial industry – should remain socially useful over the long term. For that reason I do not see firms being squeezed on the new prudential frontier but a slow iteration towards adjustment which should provide organised opportunities for run off specialists rather than disorganised opportunities.

It is difficult to disagree with Solvency II's thrust – which was born of the late 1990's high profile financial failures.

– Rene Dubois

Belcher: *The Solvency II project is a complex set of requirements that relies on a high degree of self and external regulation. It allows insurers, subject to regulatory approval, to create their own models and capital requirements that are bespoke to their own risk profile. This requires extensive regulatory oversight, and raises the risk that these models become so complex that neither investors, regulators nor even the firm's management can fully understanding them. Do you agree that Solvency II should or could be simplified?*

Dubois: The idea that market discipline should shape the standing and fate of firms off the back of some kind of published transparency is interesting within a long term horizon. The EU is perhaps interested in reducing dependency on ratings agencies but, one suspects that ratings agencies will evolve defensively and will be unavoidable for major counterparties of insurance firms. Insurance accounting is not always straight-forward. Significant industry expertise is required to comprehend the cyclical trading phenomena, behaviour, and the accounting treatments – so it is difficult to foresee that regulators will succeed any more than accountants and investment analysts although more disclosure may provide a few more parameters against which analysis can be performed.

The challenges for disclosure are – as ever – that it should be meaningful and permit relatively useful comparison between firms. Understandably firms are not happy that they should provide additional disclosure unless a global standard is forthcoming.

Regarding the use of models – one of the most important features of engaging with models is to be cognisant of their limitations – this is fully recognised within Solvency II. In my experience, non-executive directors, especially those with insurance industry experience, have shown themselves to be suitably sceptical and are fully aware of the pronouncements of senior regulators that over reliance on models has proven problematic in the past. Risk brainstorming going to the root of the business model is recognised as equally important. Even so, within Liberty Syndicates there are "independent" technical experts who review the modelling work of the capital management team and through their reports, facilitate the ability of senior managers and the Board to engage fully with the idea of model limitation.

Belcher: *The framework Solvency II directive exempts businesses that were placed into run-off before 2007. There are separate proposals for lengthy transitional periods – i.e. five years or more– for all run-off businesses before the rules fully take effect. Despite these measures, it is nonetheless clear that Solvency II will significantly impact the run-off market, both for companies already in run-off and those pushed into run-off due primarily to onerous capital requirements. What will the impact be on the run-off market?*

Solvency "II" Slow? (continued)

Dubois: The difficulty for regulators is that regulation should remain consistent for the same drivers and the perimeter should not provide too much opportunity. While professional run off has a place, there is a need to ensure that managers behave correctly in relation to the orphaned policyholders and remain responsible with their fundamental assumptions – for example regarding the evolution of long term loss costs and investment return assumptions. Run off re-insurers should look to be seen to be massively professional and to embrace Solvency II science to find real opportunities.

Belcher: *Solvency II has, through its "equivalence" regime, extra-territorial ambitions. Whilst these may be seen as consistent with the global aims and principles of the International Association of Insurance Supervisors ("IAIS"), the impacts will vary, and particularly for insurers doing international business or members of international groups. These issues are particularly prominent in the case of the United States. Where might this end up?*

Dubois: Despite the WTO's best efforts – regulation remains a potential de facto barrier to market access. For some small international markets like Switzerland and Bermuda – regulatory equivalence with the Solvency II zone has been a strategic supervisory priority for their critically important insurance industries. The US and the EEA have a range of interests but certainly are mutually interested in permitting market access to the extent that one recognises that trade is preferable to protectionism.

> *I believe Solvency II will be of ultimate net benefit to the industry. Unfortunately we must live through a phase of the Biblical Seven Lean Years…*

The Liberty Mutual Group is US-headquartered and has a reasonably well defined space for the EEA subgroup – although some re-alignments may be necessary to integrate areas of business so to simplify analytics and make them more accessible and pertinent in driving and being ultimately used in everyday operations. One must hope for a useful and enlightened agreement to focus on the key and critical issues whilst recognising a degree of regulatory diversity of approach, whereas additional regulatory domains will only be permitted to be cultivated where a justified case can be made.

The IAIS will be the critical forum to continue to forge an internationalist standard to ensure that regulation remains within its proper frame. In the IAIS arena there has been substantial progress in defining the "essence" of what should be applicable "minimum" standards for mutual recognition. Among the key test beds will be the group supervision working groups of the IAIS and the international colleges of supervisors which are becoming more prevalent. In the case of Liberty Mutual, there is a college of supervisors chaired by the Massachusetts insurance regulator and a clear focus on the economic balance sheet in the context of global operations.

Many regulators have been reconstructed and are acting regardless of Solvency II. In the UK there are two new regulators who are pushing forward aggressively, to do better where they appear not to have been able to intervene effectively, prior to the financial crisis. Their ambition is boosted, inevitably, by the fact that public policy makers are still raking over the entrails of the financial crisis. ●

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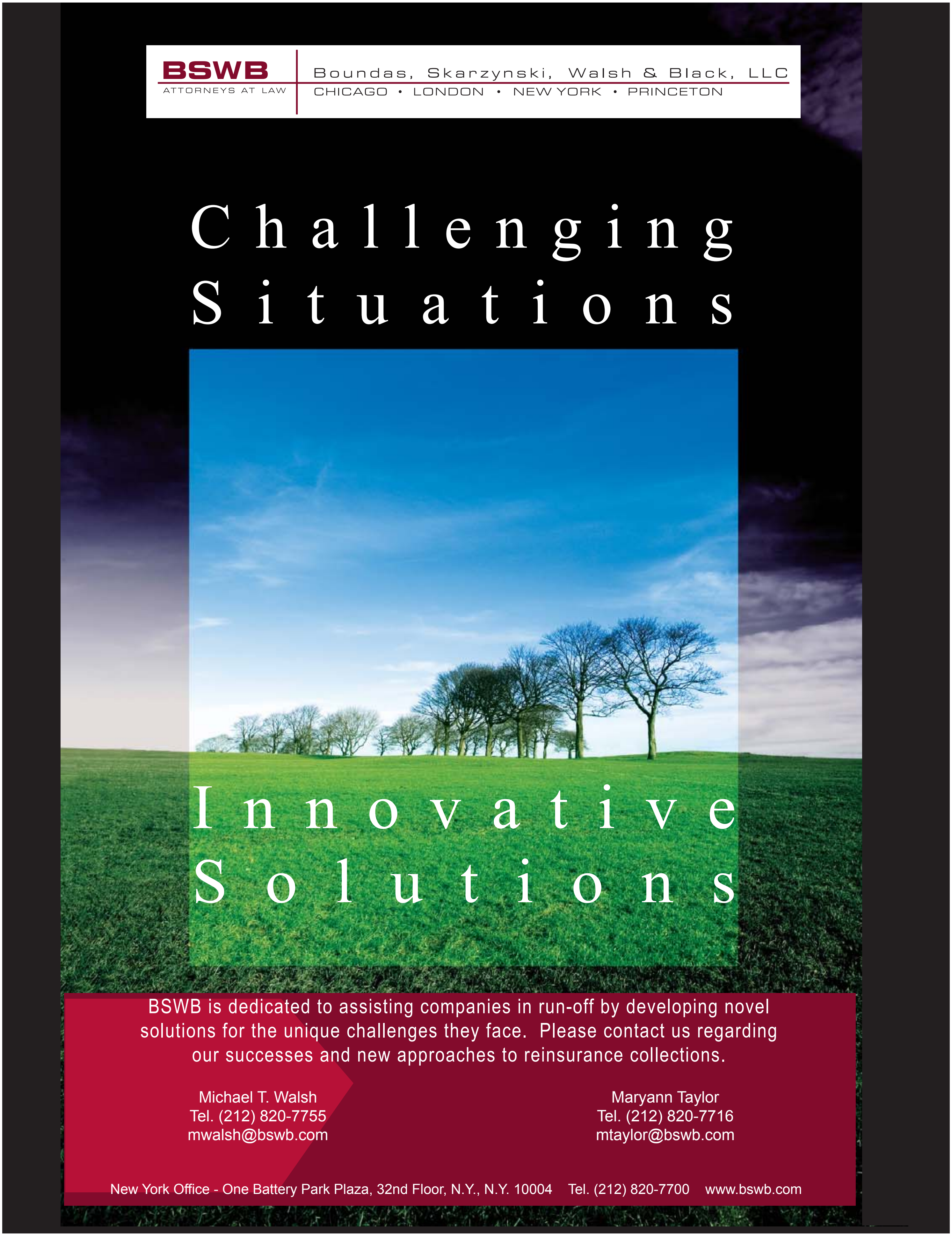
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Call Me...Maybe?

Potential Cell Phone Liability and Insurance Coverage Issues

illustration / Rafael Edwards

Cell phones have changed our everyday lives - and all those devices and all that usage have spurred new possible claims. This article discusses the potential for certain bodily injury claims, particularly brain tumors, arising from the use of cell phones or exposure to cell phone towers, the likelihood of success of such claims against cell phone manufacturers, service providers and others, and the possible coverage issues that may stem from those claims.

Background

As of June 2012, there were close to 322 million U.S. subscribers to cell phones. Approximately 36% of U.S. households only have wireless phones. Further, many individuals have more than one device and frequently upgrade to new models. According to the National Cancer Institute, the number and length of the calls and overall usage have increased.

Numerous studies about the health risks associated with cell phones have been conducted over the past 15 years and have spanned different countries and types of devices. A fair number, if not most, conclude there is no demonstrable or significant connection between radiofrequency emissions from cell phones and cancer or brain tumors. However, an oft-cited study was published by the World Health Organization's ("WHO") International Agency for Research on Cancer ("IARC") in May 2011. The panel, consisting of 31 scientists, concluded that cell phones present a "carcinogenic hazard," the lowest category given to potential carcinogens. The study said that cell phone use presents "some risk" of two types of rare tumorsThe U.S. Food and Drug Administration ("FDA") "believes that the weight of scientific evidence does not show an association between exposure to radiofrequency from cell phones and adverse health outcomes." The FDA says that further research is needed to determine whether differing variables, such as age of the user, the duration/frequency of use, age of the device and nature of the injury, influence the results of these studies.

The volume of cases remains modest when compared to the number of cell phones used over the same period of time.

The U.S. Federal Communications Commission ("FCC") requires that "all wireless communications devices sold in the United States meet its minimum guidelines [set in 1996] for safe human exposure to radiofrequency (RF) energy." In 2012, the FCC said it would undertake a "routine review" of its standards. In the same year, the U.S. Government Accountability Office urged the FCC to revisit its guidelines.

Despite the lack of scientific consensus, steps to reduce possible exposure are being promoted. For example, the FDA encourages the use of a speakerphone or earpiece. The WHO recommends the use of hands-free devices and texting. Some European governments or officials warn people not to carry their cell phones near vulnerable parts of their bodies. They also suggest that children limit the use of cell phone devices.

Lawsuits Arising from Cell Phone Use

Despite the absence of a scientific consensus for causation, lawsuits have been and continue to be filed against manufacturers and retailers of cell phone devices. Lawsuits arising out of cell phone injuries tend to assert typical product liability claims, often alleging fraud and misrepresentation, strict liability, negligence/failure to warn, defective manufacture and design, breach of implied warranty of merchantability and statutory claims (such as consumer protection acts).

These lawsuits have faced numerous procedural and substantive challenges. For example, in Farina v. Nokia Inc., 625 F.3d 97 (3d Cir. 2010), a federal appellate court ruled that there is no cause of action if the device meets the FCC guidelines applying to cell phones manufactured in or after 1996. A different appellate court, in Pinney v. Nokia Inc., 402 F.3d 430 (4th Cir. 2005), allowed a case despite the preemption issues because the plaintiffs asserted that defendants "negligently and fraudulently endangered the consuming public by marketing wireless telephones without headsets."

…the volume of cases remains modest when compared to the number of cell phones used over the same period of time. Both preemption and causation issues remain, creating a steep burden for plaintiffs.

Even when cases have proceeded, plaintiffs have found it difficult to establish causation. For instance, in Newman v. Motorola, Inc., 218 F. Supp. 2d (D. Md. 2002), aff'd, 78 Fed. Appx. 292 (4th Cir. 2003), the plaintiff claimed he developed brain cancer after using a cell phone for about 60 hours a year for five and a half years. Plaintiff's expert witnesses were all excluded by the district court. The federal appellate court affirmed, finding there was no reliable evidence that cell phone users faced an increased risk for malignant brain tumors.

Both preemption and causation issues remain, creating a steep burden for plaintiffs.

Outside the U.S., on October 12, 2012, Italy's high court ruled that cell phone use caused a plaintiff's brain tumor. The Supreme Court of Cassation affirmed the lower court's finding in favor of the plaintiff and agreed that the plaintiff presented credible evidence that the cranial nerve tumor was causally linked to his cell phone use which was estimated to be five to six hours per day for 12 years. The case was unusual in that there were no cell phone defendants and the case was instead against the Italian authority which had denied the plaintiff's workers' compensation claim.

In early 2013, a customer of an Israeli cell phone company sued the company, contending he developed lymphoma in his left ear. The customer made or took many calls from his home office that had limited cell reception. He argued that in areas with low cell reception, the electromagnetic radiation from cellular phones is increased. The defendant, which stressed that it adheres to all industry safety guidelines, agreed to settle with plaintiff for roughly $100,000 as a "humanitarian gesture."

Back in the United States, plaintiffs in a group of cases currently pending in the District of Columbia Superior Court have alleged that they developed cancer or tumors from their cell phone use and seek compensation from a number of industry defendants. At some point this year, the court will hear arguments on general causation issues in at least several of the cases.

Despite the years of various studies and even with the recent Italian and Israeli developments, the volume of cases remains modest when compared to the number of cell phones used over the same period of time. Both preemption and causation issues remain, creating a steep burden for plaintiffs. In the absence of an injury uniquely the result of radiofrequency exposures, factfinders will also have to address whether cell phone use was the sole or a substantial cause of a plaintiff's alleged injuries. Also, there could be challenges associated with tying injuries to a particular defendant, depending on a plaintiff's particular purported exposure relating to the number of cell phones, number of manufacturers, frequency and duration of usage, conditions of usage, and more.

Lawsuits Arising from Exposure to Wireless Transmitters

The increased demand for devices has created a boom in the need for wireless antennae, or "cell phone towers," which

Call Me…Maybe? (continued)

are found on buildings, utility poles, signs and roofs. There are approximately 500,000 cell phone towers in the U.S. and industry insiders believe the number will increase in the coming years since the current data networks require much greater cell-site density than traditional voice networks. Both A.M. Best Company (2013) and Business Insurance (2011) have identified such sites as potential risks because of the high dose radiation they emit on a continuous basis.

It will be important to monitor further scientific research, expert testimony and government regulation and assess the impact on filings against cell phone industry defendants, particularly for insurers with policies containing a duty to defend.

Over 250,000 workers in the United States are at risk for exposure to this high dose radiation, according to the Bureau of Labor Statistics and Census Bureau data cited by Business Insurance. Personnel who may work with or close to the antennae or towers include employees of the wireless industries, roofers, painters, heating and ventilation technicians, and others. At high doses, radiofrequency energy can affect body tissue and may, as noted by A.M. Best, result in "eye damage, sterility and cognitive impairments." The FCC guidelines concerning maximum specific absorption rates apply to such exposures. There has, however, been relatively limited litigation in this context thus far. One such case was AT&T Alascom and Ward North America Inc. v. John Orchitt, et al., 161 P.3d 1232. In 2007, the Alaska Supreme Court affirmed a disability award to an AT&T employee who was exposed to radiofrequency radiation that was over FCC limits and began to suffer headaches, eye pain, mental slowing and depression. Plaintiffs in litigation of this type also face the preemption and causation challenges discussed above.

Coverage Issues

Wireless industry defendants have looked and will continue to look to their insurers, whether the allegations in the litigation arise out of injury from wireless devices or the towers. The availability of coverage depends upon the particular policy language, the facts of the underlying litigation, the applicable law, and other such issues.

It will be important to monitor further scientific research, expert testimony and government regulation and assess the impact on filings against cell phone industry defendants, particularly for insurers with policies containing a duty to defend.

In the relatively few cases to date, policies containing a duty to defend have generally been found to have been triggered by allegations of bodily injury in the lawsuits filed against the insureds. See, e.g., Zurich American Ins. Co. v. Nokia, Inc., 268 S.W.3d 487 (Tex. 2008). Defense costs have the potential to be significant, particularly in the context of putative or certified class actions.

Some cases have addressed what constituted "damages" under the policies, with some unsuccessfully arguing that costs to provide plaintiffs with headsets or to provide for medical monitoring do not arise out of bodily injury. Finding coverage were, for example, Motorola Inc. v. Associated Indemnity Corp., 878 So.2d 838 (La. App. 2004) and Northern Ins. Co. of N.Y. v. Baltimore Business Communications, Inc., 68 Fed. Appx. 414 (4th Cir. 2003).

Coverage litigation could also involve issues of fortuity, notice, applicable exclusions, trigger, allocation, number of occurrences and more. Many of these topics will be highly fact-dependent. An example of a coverage action with some of these subjects is Valley Forge Ins. Co., et al. v. Palm Inc., et al., Case No. 12 CH 35601 (Cir. Ct., Cook Cty., filed Sept. 20, 2012). The plaintiff insurer seeks a declaration of no coverage based, in part, on an "Electromagnetic and Ionizing Radiation Exclusion" and on expected and intended grounds. The lawsuit is in the early stages but bears watching.

Comments on the Future

Will cell phone claims "ring off the hook" … or is this a "wrong number"? The explosion in the number of cell phones, users and usage over the years suggests a large potential population of claimants. However, causation and other legal issues remain daunting for potential plaintiffs. It will be important to monitor further scientific research, expert testimony and government regulation and assess the impact on filings against cell phone industry defendants, particularly for insurers with policies containing a duty to defend. Depending on the results of the scientific studies, more investigation may occur into what the cell phone industry defendants understood the potential risks of cell phone use or cell tower exposure to be and when they had that knowledge. Insurers and insureds will also need to remain aware of coverage law developments in potentially applicable jurisdictions as they consider whether policies may provide coverage for defense or indemnity. So, while observers will "hit redial" often, projecting the future of cell phone claims and related coverage issues is – for now – "on hold."


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Follow-the-Settlements

Transparency and the Attorney-Client Privilege

Jennifer R. Devery &
Christie S. Mizer

A bedrock principle of reinsurance is that reinsurers must follow their cedants' settlements. A reinsurer may not second-guess a cedant's reasonable, good-faith decision that the underlying insurance policies covered the risks at issue; nor can the reinsurer second-guess the cedant's good faith interpretation of policy terms. This principle allows cedants to efficiently investigate and defend a claim and, if warranted, settle on the best terms possible.

However, the broad discretion cedants enjoy from the follow-the-settlements doctrine is subject to concomitant obligations cedants owe to their reinsurers to only pay claims that are covered under the policy and to act reasonably and in good faith in their settlement and allocation decisions. *See American Employers Ins. Co. v. Swiss Reins. Am. Corp.*, 413 F.3d 129, 136 (1st Cir. 2005) ("It is well settled that to trigger the deference due under a follow-the-fortunes clause the cedant's settlement must be made in good faith"); *U.S. Fidelity & Guar. Co. v. American Re-Ins. Co.*, 2013 N.Y. Slip Op. 00784, 2013 WL 451666 (NY Feb. 7, 2013) ("Recognizing that the cedant's and the reinsurer's interests will often conflict, courts generally hold that a reinsurer is bound only by a cedant's 'good faith' decisions.").

A reinsurer must have some opportunity to evaluate its cedant's conduct in settling claims for which indemnity is sought under a reinsurance contract. The cedant must disclose to it's reinsurer enough of its claims handling process to make a prima facie showing that the cession is appropriate, professional and made in good faith. As one commentator notes:

> The concepts of utmost good faith and fiduciary obligation underlie the reinsurance concept of transparency. For the reinsured business, the structure, operation, and management of the cedant should be transparent to the reinsurers; that is, the reinsured should not conceal its operations from its reinsurers. If the cedant is unwilling to be transparent, an issue arises as to whether the obligations of utmost good faith are being breached.

Robert W. Hammesfahr and Scott W. Wright, *The Law of Reinsurance Claims* 74 (2d ed. 1998).

These reciprocal obligations are often in the parties' reinsurance contracts in specific clauses that provide that a reinsurer's liability follows its cedant's liability and that the cedant must afford its reinsurer access to all records relating to the contract or claims thereunder.[1]

> *...the broad discretion cedants enjoy from the follow-the-settlements doctrine is subject to concomitant obligations cedants owe to their reinsurers...*

Tension arises when a cedant uses in-house and/or outside counsel to analyze its potential exposure to a policyholder's claims. Often, counsel's advice and analysis is among the best sources of information explaining the cedant's position, a review of which allows a reinsurer to comprehensively and efficiently ascertain if the settlement is reasonable. Some cedants, however, refuse to disclose these analyses due to several recent cases holding that such sharing may waive the privilege vis-à-vis the cedant's policyholder.

From a legal perspective, whether a court will find that a cedant waives the attorney-client privilege by disclosing information to its reinsurer turns on whether these parties share a "common interest." Because the "common interest" doctrine is an exception to the general rule that voluntary disclosure of privileged information waives any privilege, courts require that the shared interest be of a legal nature and not strictly commercial. Also, courts typically require a showing that the privileged information exchange was made in the course of formulating a common legal strategy.

For some courts, the very nature of the reinsurance relationship satisfies the elements of the common interest doctrine. *See, e.g., Hartford Steam Boiler Inspection and Ins. Co. v. Stauffer Chem. Co.*, 1991 WL 230742 (Conn. Super. Ct. Nov. 4, 1991) ("[t]he legal and economic interests of [the insurer and reinsurer]… are inextricably linked by the reinsurance treaty"). Other courts, however, have held that the cedant-reinsurer relationship, in and of itself, does not create a common interest that would preserve the privileged nature of the shared documents. *See, e.g., Reliance Ins. Co. v. Am. Lintex Corp.*, 00 Civ 556 (WHP) (KNF), 2001 WL 604080 (S.D.N.Y. June 1, 2001) ("existence of [insurer-reinsurer relationship] alone is not a sufficient basis upon which to find that the attorney-client privilege shields from disclosure the material").

In *Fireman's Fund Ins. v. Great Am. Ins. Co. of N.Y.*, 28 F.R.D. 132 (S.D.N.Y. 2012), the Southern District of New York went the latter route, finding the cedant-reinsurer relationship alone insufficient to trigger the common interest doctrine to protect disclosure of otherwise privileged communications. In that case, a policyholder moved to compel the production of certain documents that the insurer shared with its reinsurer. In opposing the motion, the insurer argued that the privilege remained intact, notwithstanding this reinsurance disclosure, because the reinsurer bore the same risk the insurer bore under the policy with the policyholder. Thus, given the follow-the-fortunes doctrine, the insurer asserted that it and its reinsurer shared a joint legal interest in the outcome.

In rejecting the insurer's argument, the court refused to adopt a "categorical rule" that insurers and their reinsurers share a common interest merely because

Follow-the Settlements (continued)

a reinsurer's payment obligations are necessarily tied to the cedant's payment obligations. Rather, the court held that there must be more shown to establish that the insurer and reinsurer shared a legal, not commercial, interest in the outcome of the coverage action.

Importantly, the *Fireman's Fund* court did not suggest that a common legal interest could never exist between an insurer and reinsurer. Rather, the court cited to *North River Ins. Co. v. Columbia Cas. Co.*, No. 90 Civ. 2518 (MJL) (JCF), 1995 WL 5792 (S.D.N.Y. Jan. 5, 1995), where the court concluded that whether a common interest existed required a fact-intensive scrutiny and could be demonstrated by "an agreement establishing a joint prosecution, a coordinated legal strategy, shared legal expenses, or that one party exercised control over the conduct of the action." However, in *Fireman's Fund*, the court concluded that the cedant failed to produce this type of evidence and to demonstrate that it and its reinsurer had forged a "cooperative and common enterprise towards an identical legal strategy." 28 F.R.D. at 139 (*quoting Lugosch v. Congel*, 219 F.R.D. 220, 237 (N.D.N.Y. 2003)). As such, the court held that any privilege associated with documents shared with the reinsurer had been waived.

* * *

To function efficiently and economically, the reinsurance relationship requires a high level of mutual trust and confidence, facilitated by the parties' free exchange of information. When making disclosures about the merits of a policyholder's claim and seeking indemnification from reinsurers, however, a cedant should proceed with caution since some courts will not automatically include those reinsurers within the protection of the attorney-client privilege.

To address this, cedants and reinsurers should consider the following:

Memorialize Parties' Common Interest Prior to Disclosure. To strengthen the likelihood of a court recognizing the inherent common interest between a cedant and its reinsurers, thereby lessening the possibility of waiver, parties should consider entering into a Common Interest/Confidentiality Agreement. Courts are more likely to find that a cedant and reinsurer have a common legal interest in the outcome of coverage litigation if it is memorialized in advance of disclosing privileged communications. *See, e.g.*, *North River*, 1995 WL 5792.

Courts are more likely to find that a cedant and reinsurer have a common legal interest in the outcome of coverage litigation if it is memorialized in advance...

Delay Adversity. Adversity between cedant and reinsurer undercuts any assertion of a common interest. For example, one court recently held that an insurer waived any privilege over its documents by sharing them with its reinsurers when the insurer's and its reinsurers' interests were not aligned, evidenced by the fact that the insurer had engaged in two contested arbitrations with its reinsurers. *Regence Group v. TIG Specialty Ins. Co.*, No. 07-1337-HA, 2010 WL 476646 (D. Or. Feb. 4, 2010). The court's opinion ignored the fact that, at the time some materials at issue were disclosed, the insurer and reinsurers were not adverse to one another. Therefore, to lessen the possibility of a retroactive waiver of privilege, parties should consider delaying the filing of formal legal proceedings between themselves until the underlying policyholder's claim is resolved.

Disclose Pursuant to a Court or Arbitration Panel Order Requiring Production. Some courts have held that a party does not waive the attorney-client privilege when the disclosure was done pursuant to an order from a court or arbitration panel. *See, e.g.*, *Rambus, Inc. v. Infineon Auth.*, 220 F.R.D. 264 (E.D. Va. 2004). Accordingly, if a cedant and reinsurer cannot avoid litigating or arbitrating before the underlying policyholder dispute is concluded, a cedant might consider resisting the disclosure of sensitive communications until so ordered by a court or panel. In that case, a cedant could bolster its argument that no waiver occurred because the disclosure was involuntary and compelled. *Id.*; *but see Regence Group*, 2010 WL 476646 (ordering production of privileged communications disclosed pursuant to an arbitration panel's order).

Weigh the True Risk of Waiver. Regardless of the precautions taken at the time, there is always a risk that a cedant's disclosure of privileged information to its reinsurers could later be found to constitute a waiver of privilege. Nevertheless, the magnitude of that risk varies greatly. For example, if the underlying policyholder dispute is resolved through the insurer's policy buy-back, the impact of any potential waiver is significantly diminished as the policyholder will have little or no interest in seeking coverage analyses pertaining to the bought-back policies. On the other hand, when an insurer is in a contentious coverage fight with its policyholders, there is a greater likelihood that a policyholder will seek such communications and the potential that a finding of waiver could substantially increase the value of the policyholder's claim. Therefore, cedants and reinsurers should work together to best balance the need for complete transparency in the reinsurance relationship with the parties' collective interest against creating additional exposure to the policyholder's claims. ●

Endnotes

1 Issues regarding the scope of disclosure that a cedant must make to its reinsurer and the risks associated with such disclosure are inherently fact-dependent and are not amenable to a one-size-fits-all analysis. As such, this article is meant solely to highlight a potential issue and offer ideas for discussion.

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The New (semi) Confidential Arbitration Award

A significant number of reinsurance contracts, particularly treaties implicated in claims involving runoff operations, contain arbitration clauses but do not require that the arbitration be confidential. Nevertheless, many ceding companies and reinsurers alike continue to prefer the "traditional" approach: to conduct their arbitrations in private and treat the process and result as confidential. If that is the preference of the parties to a dispute, they ordinarily execute a confidentiality agreement to that effect and anticipate the entire arbitration, including the award itself, will remain confidential, even if the dispute ends up in court. Until fairly recently, the parties could have been confident that their expectations would be fulfilled.

In recent years, however, some courts have refused to seal post-arbitration proceedings (*i.e.* motions to confirm and/or vacate an arbitration award) despite a joint request by both parties, thereby exposing arbitration materials that the parties agreed to keep confidential to public review and potential use in later proceedings. The divergence among courts creates the potential that parties may be able to influence, after the arbitration, whether agreed-upon confidentiality is maintained, or not, by choosing or avoiding a "pro-disclosure" venue for post-arbitration motions. It is therefore important for all parties to enter the process with "eyes wide open" with respect to confidentiality.

Certain Courts View Confidentiality Agreements with Skepticism

The recent decision by the United States District Court for the Southern District of New York in *Century Indemnity Company, et al. v. AXA Belgium* (*f/k/a Royale Belge Incendie Reassurance*), 2012 WL 4354816 (S.D.N.Y. Sept. 24, 2012) is indicative of this trend in the Southern District of New York (and other courts across the country). The Court held that a written confidentiality agreement in a reinsurance arbitration was insufficient to overcome the presumption of public access to court documents when the parties brought to court their dispute about whether the arbitration award should be confirmed or vacated.

The SDNY's approach to the parties' motion to seal in *AXA* is typical of that court's recent attitude towards such motions. The court was presented with cross-petitions to confirm and vacate three related reinsurance arbitration awards, and multiple motions to seal various documents from those arbitrations, *id.* at *1, as required by the confidentiality agreement the parties previously executed.[1] *Id.* at *12. After granting the petition to confirm the awards and denying the petition to vacate, the court turned to the parties' complimentary motions to seal certain arbitration documents. *Id.* at *13-14. After concluding that the arbitration documents and related pleadings were "judicial documents" to which a presumption of access attaches, the court performed a balancing test, *id.* at *13, balancing "competing considerations that include, but are not limited to, the danger of impairing law enforcement or judicial efficiency and the privacy interest of those resisting disclosure." *Id.* at *13.

Though admitting that the public interest in the relationship between an insurer and its reinsurers is relatively low, the court reasoned there was great public interest in the workings of the court, including the arbitration awards and other arbitration information. *Id.* at *14.[2] Finally, the court concluded that neither the parties' reliance on their confidentiality agreement nor their expectation as a result of their agreement to arbitrate rather than litigate was sufficient to overcome the presumption in favor of access. *Id.* The court held the mere existence of a confidentiality agreement did not, without more, demonstrate that sealing was necessary, *Id.* The SDNY has employed similar reasoning to justify public access to reinsurance arbitration information that the parties sought and agreed to keep confidential in a string of recent decisions.[3]

The Proper Forum for Post-Arbitration Motions and Its Potential Effect on Confidentiality

With some courts refusing to seal arbitration records, a critical issue with respect to a court's willingness to seal the record is whether the parties have a choice of where to file post-arbitration motions. Conventional wisdom is that motions to confirm and/or vacate under the Federal Arbitration Act ("FAA"), 9 U.S.C. §1, et seq., should be brought in the jurisdiction in which the arbitration was held. With so much arbitration activity in New York City, that means the (adverse to sealing) SDNY. However, there may be other options. According to the United States Supreme Court's March 2000 decision in *Cortez Byrd Chips, Inc. v. Bill Harbert Construction Co.,* 529 U.S. 193 (2000), even though the FAA's provisions regarding venue for motions to confirm or vacate (§§ 9-11) only mention the federal district court where the parties agree venue is proper or where an award was made, those provisions are permissive, not mandatory – that is, a motion to confirm or vacate an arbitration award can also be brought in any other district where venue for a civil action would be proper under federal law.

Cortez involved competing actions to vacate and confirm an arbitration award arising out of a construction dispute, brought respectively in federal court in Mississippi (where the contract was performed) and, seven days later, in federal court in Alabama (where the arbitration was held and the award issued). *Cortez,* 529 U.S. at 195-196. When the petitioner in the Mississippi action moved to dismiss, transfer or stay the Alabama action, the Alabama District Court denied the motion on grounds that Alabama, where the arbitration was held and the award returned, was the *only* court in which venue was proper under the FAA. *Id.* at 196. The Alabama District Court confirmed the award, and the Court of Appeals for the Eleventh Circuit affirmed. *Id.* at 196. A unanimous Supreme Court reversed, holding that the venue provisions of sections §§ 9-11 of the FAA were permissive, not mandatory. *Id.* at 204. According to the Court, a permissive view of the venue provision is the only one consistent with the obvious congressional intent to expand venue choices through enactment of the FAA. The Court therefore held that the proper venue for a motion pursuant to §§ 9-11 of the FAA includes any venue on which the parties agreed, or the award was returned (as provided by the FAA itself) or in which venue would otherwise be appropriate under the general federal venue statute (*i.e.* where the defendant resides or where a substantial part of the events or omissions giving rise to the claim, like performance of a contract, occurred). *Id.* at 200; *see also* 28 U.S.C. § 1391.

…it may be time to rethink and revise the "standard" confidentiality agreements used in arbitrations.

Having a choice of venue may have the unintended consequence of further complicating a system that many in the industry believe is already in need of repair. The question arises in the reinsurance (or the direct insurance) context whether these forum options for post-arbitration proceedings present an opportunity for parties to gain an unfair, and maybe unanticipated, advantage. For example, when parties to arbitration begin the dispute resolution process, they may be on equal footing when deciding whether to agree to confidentiality---both sides could win or lose the arbitration. If both parties agree to conduct the arbitration on a confidential basis, or the Panel orders confidentiality in the face of a dispute on the issue, the parties will make the necessary efforts to have a court seal the record in any post-arbitration proceedings. Given *Cortez*, however, the successful party to the arbitration could file a motion to confirm in a district court it knows is loathe to seal the record. In fact, while some parties may have found a motion to confirm a particular award unnecessary in the past, when courts sealed the record almost as a matter of course, they might now file a motion to confirm in a favorable jurisdiction just to get the award publicized. In addition, the choice of forum issue may create a race to the courthouse, with each party filing its motion to confirm or vacate in a jurisdiction most favorable to their position with regard to confidentiality. While such actions may be contrary to the spirit of the confidentiality agreement or order, there appears to be no restriction in the typical confidentiality agreement to prevent such a scenario.

Conclusion

In light of the refusal by some courts to maintain the confidentiality of certain arbitration information, parties need to be careful about the disclosures they make during the course of the arbitration in case they become public at some point in the future. As a result, it may be time to rethink and revise the "standard" confidentiality agreements used in arbitrations. Perhaps there is some information both parties would agree should not be made public under any circumstances. The parties could agree from the start that such documents will not be attached to, or discussed in, any court record that is not sealed. Similarly, if parties limit their request that a court seal just those truly confidential parts of the record, they may be able to convince the court that their interests in confidentiality outweigh public access. Not only would this maintain the parties position on confidentiality, but it could reduce risk and expense in the arbitration process. In the meantime, the parties to the dispute should be fully aware of these developments and proceed with appropriate caution.

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Endnotes

1 Based on language from the confidentiality agreement quoted in the opinion, it appears the parties were employing a standard-form confidentiality agreement available through the AIDA Reinsurance and Insurance Arbitration Society (better known as ARIAS U.S.). *See id.* at *12. The ARIAS U.S. standard-form confidentiality agreement provides that all "Arbitration Information," which includes "all briefs, depositions and hearing transcripts generated in the course of [the] arbitration, documents created for the arbitration or produced in the proceedings by the opposing party or third-parties, final award and any interim decisions, correspondence, oral discussions and information exchanged in connection with the proceedings," "will be kept confidential." Further, "the parties agree, subject to court approval, that all submissions of Arbitration Information to a court shall be sealed."

Continued on page 40

Lions and Cheetahs (oh my!)

The familiar saying about spring is "in like a lion, out like a lamb."

For AIRROC and me, spring did arrive like a lion, but we are going out like a cheetah. The cheetah, the fastest land mammal, can run up to 75 mph. AIRROC and I are keeping in stride like a cheetah as we look ahead at the summer and the very busy schedule that I have planned for our members.

A welcome to our new Executive Committee – in March Kathy Barker (Excalibur) and Marianne Petillo (ROM) began their new roles as Co-Chairwomen, and Ed Gibney (CNA) as Vice Chairman.

I took some time on the train traveling back from the New York City April Regional Education day to both enjoy the scenery and reflect on the event. With DLA Piper's assistance, we held another terrific event for AIRROC – great speakers, diverse topics, and a large number of attendees. Though exhausted from the preparations and the energy it takes to successfully complete our events, I find myself energized by seeing so many attendees involved in the organization and the industry.

Look for summaries and photos from our March and April events on the AIRROC website. Next we head to Chicago on June 13 for our Regional hosted by Sidley LLP and PwC. For fall we have just announced two dates – September 10 for our New York DRP Workshop and September 19 for our West Coast Regional. Mark your calendar for these programs.

The 2013 Commutation and Networking Event is being held at the Sheraton Meadowlands on October 13-16. We have a new format and new events. Look for Ed Gibney's article in this issue for more details and make sure you join us for this annual signature event!

Are there ideas, topics, events, and locations that AIRROC should consider

Pictures don't lie. **This collage reflects members enjoying our March and April Educational sessions,**

for 2014? Let me hear from you. Cheetahs also have a keen sense of hearing – I am always listening. ●

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

Thanks to Our Corporate Partners

AIRROC is pleased to recognize and thank the Corporate Partners who make it possible to serve our membership. Their contributions and continual support underpin the organization's initiatives allowing us to provide education, networking, AIRROC Matters magazine, and a full range of industry-specific services.

We invite each of you to become a new Corporate Partner and contribute to our organization's legacy of success. Partner benefits include complimentary attendance at meetings, speaking opportunities, and significant branding at our events, on our website and in AIRROC Matters.

Want to learn more? Contact Carolyn Fahey at 703.730.2808 or carolyn@airroc.org. ●

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summaries of which are available online at www.airroc.org/heard-and-seen-at-airroc-events.

photos / Jean-Marc Grambert

AIRROC / R&Q 9th Annual Commutations & Networking Event – October 2013

The AIRROC Board of Directors and R&Q are looking forward to welcoming you to our 9th Annual Commutations and Networking Event on **October 13-16, 2013.**

We have selected the Sheraton Meadowlands Hotel and Conference Center in East Rutherford, New Jersey as our host hotel. Many may remember this location from events pre-2009. They are undergoing exciting new changes which will make your experience better than ever.

The Hotel is undergoing a complete renovation in anticipation of hosting the 2014 Superbowl. AIRROC attendees will get the benefit of being one of the first groups to experience the complete renewal of the conference facilities, sleeping rooms, and restaurants.

The location offers easy and affordable access into Manhattan via train, bus, or car—and our hotel shuttle provides quick and free service to Harmon Meadow Outlet Mall and Secaucus Rail servicing Penn Station and Newark Liberty Airport. Round-trip train service into New York City is about $8 and $25 to Newark Liberty Airport.

We have a new format which still features many of the events that attendees have learned make the October event a must attend as well as some new features.

NEW for 2013: Consolidated Agenda

NEW for 2013: Tuesday evening reception/dinner New York City Harbor Cruise on the state of the art Hornblower Hybrid yacht

NEW for 2013: Two half-day education sessions with CLE credit (8-12 on Monday and Tuesday)

NEW for 2013: Reserved meeting tables all day Monday and Tuesday

NEW for 2013: Wednesday morning departure breakfast

Two Receptions: Sunday and Monday

Three Breakfasts: Monday, Tuesday and Wednesday

Two Lunches: Monday and Tuesday

The announcement of the AIRROC Run-off Person of the Year

Women's Luncheon and Keynote

Registration Rates:

AIRROC Members get one free registration per company, additional delegates from member companies pay only $595/£400.

Non-member rate is $895/£600.

Education Sessions only $395 members and non-members

Hornblower Cruise only $250 for members or non-members.

Meeting Table Reservation Fee: $500 for members or non-members.

If you are interested in becoming a sponsor, please contact Carolyn Fahey at carolyn@airroc.org.

We look forward to seeing you there! ●

— Ed Gibney

SUMMER 2013 MARK YOUR CALENDAR

June 5-7
IAIR Technical Development Series IV
Las Vegas, NV
www.iair.org

July 9-10
Summer Membership Meeting
New York, NY
www.airroc.org

August 24-28
NAIC Summer National Meeting
Indianapolis, IN
www.naic.org

September 10
DRP Workshop
New York, NY
www.airroc.org

September 19
West Coast Regional Education Session
Newport Beach, CA
www.airroc.org

October 13-16, 2013
AIRROC/R&Q Commutation & Networking Event
East Rutherford, NJ
www.airroc.org

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News & Events

Regulatory News

FIO Watch

The latest pronouncement from the Federal Insurance Office's Director, Michael McRaith, is that its long-awaited report on recommendations for modernizing and improving insurance regulation will be released before July. The FIO is also supposed to issue a report on the ability of state regulators to access reinsurance information. In this regard, the NAIC's Reinsurance Task Force, at its Spring meeting in April, announced that it would conduct a survey at the request of the FIO.

The FIO request derives from the Nonadmitted and Reinsurance Reform Act within the Dodd-Frank Act pertaining to Credit for Reinsurance, and seeks input on the ability of state regulators to access reinsurance information, particularly by states other than the domiciliary state of the reinsurer. As of this writing, a mechanism for the survey has yet to be determined.

To assist the FIO in conducting its statutory requirement to study and issue a report to Congress on the "current state of the market for natural catastrophe insurance in the US," the FIO is soliciting comments. Please refer to the link below to the April 24th Federal Register for further information and detailed issues that the FIO is seeking information on. The comments are due no later than June 24, 2013.

https://federalregister.gov/a/2013-09670

New Mexico Moves to Create Independent Insurance Department

In March 2013, the New Mexico legislature passed legislation creating the framework for an independent insurance department. The legislation implements the voter-approved constitutional amendment adopted last year removing the regulation of insurance from the Public Regulation Commission by establishing a stand-alone department of insurance. The law also establishes a process for nominating and electing an independent superintendent of insurance by July 1, 2013. New Mexico thus becomes the 12th state with an elected insurance commissioner.

Industry News

R&Q to Redomesticate from UK to Bermuda

Citing, among other things, delays in implementing Solvency II, Randall & Quilter, the specialist non-life insurance investor, service provider and underwriting manager, announced that it is redomesticating to Bermuda. According to its press release, "the Redomicile is an integral step in [R&Q's] aim to secure enhanced transparency and certainty on its medium to long-term capital requirements in the face of a series of delays in the implementation of the Solvency II regime for EEA based insurance groups."

Brit Insurance Acquires Renewal Rights from Maiden Holdings

Brit Insurance ("Brit") announced that, through its U.S. service company, Brit Global Specialty U.S.A., Brit will assume all renewal rights of Maiden Specialty, the excess and specialty unit of Maiden Holdings, Ltd. located in Bermuda. Ultimately the renewals of the assumed business will be written into Brit Syndicates 2987. As part of the arrangement, Brit Global Specialty will employ all Maiden Specialty staff.

Hamburg buys run-off from Niedersachsen

In March 2013, HamburgInternationale Rückversicherung (HIR), part of the Tawa group, acquired Niedersachsen Versicherungs AG's reinsurance portfolio, which contains predominantly liability and marine contracts in run-off. This follows as series of acquisitions over the past few years, including the acquisition of all assumed reinsurance contracts of Niedersachsen Versicherungs AG in January 2013.

People on the Move

AIRROC Board member, **Michael Fitzgerald**, has been appointed a Principal of Inpoint, a global strategy and operations consulting division of Aon Benfield, providing solutions globally to insurance and reinsurance companies. He is responsible for developing business opportunities across Inpoint's three practices: strategy, claims and operations.

John M. Nonna, co-chair of the Patton Boggs Insurance and Reinsurance

Dispute Resolutions Practice Group, has been named managing partner of the firm's New York office.

New Officers at RAA: At its annual meeting in April, the Reinsurance Association of America elected **Tad Walker** of PartnerRe North America as Chair; **Tad Montross** of Gen Re was elected as vice chair; and **Pina Albo** of Munich Re was elected as secretary-treasurer.

Berkshire-AIG Shuffle: In April, Berkshire Hathaway hired four senior commercial insurance executives away from AIG: **Peter Eastwood**, president and CEO of AIG Property/Casualty; **David J. Bresnahan**, president of AIG's Lexington unit; **Sanjay Godhwani**, president for Latin America and the Caribbean for AIG's P&C operations; and **David Fields**, chief reinsurance officer at AIG. AIG has replaced most of the vacant positions from within: **Robert Schimek** (president & CEO of AIG Property Casualty's Americas region); **Alexander Baugh** (heading AIG's global casualty business); and **Nicholas Walsh** (president & CEO of AIG's Europe, Middle East, and Africa region). ●

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 or Peter Bickford at pbickford@pbnylaw.com.

illustration / Rafael Edwards

Tempest in a teapot

New York's Bi-Economy Decision Five Years Later

New York courts have a general reputation as being insurer-friendly in their resistance to policyholder claims for damages beyond policy coverage terms and limits. Historically, New York courts refused to recognize contract-based bad faith claims for breach of a first-party insurance contract. Insureds have fared no better proceeding under a tort theory of bad faith liability, absent "egregious tortious conduct" and "a pattern of similar conduct directed at the public generally." *See Roconova v. Equitable Life Assurance Society*, ***83 N.Y. 603, 615 (N.Y. 1994).***

In 2008, however, two decisions by New York's highest court – *Bi-Economy Market, Inc. v. Harleysville Insurance Co.*, 10 N.Y.3d 187 (N.Y. 2008), and a companion decision handed down on the same day, *Panasia Estates, Inc. v. Hudson Insurance Co.*, 10 N.Y.3d 200 (N.Y. 2008) – threatened to alter the legal landscape in New York by recognizing a policyholder's right to seek recovery of consequential damages beyond policy limits where such damages were the direct consequence of insurer claims handling that violated the insurer's obligation of good faith and fair dealing and were foreseeable by the parties at the time the policy was issued.

The *Bi-Economy* decision initially caused jurists and insurers to speculate as to whether the decision had opened the floodgates to claims against insurers beyond policy limits. Much of the speculation centered on Judge Robert S. Smith's strongly-worded dissent in *Bi-Economy*, which predicted that the majority's decision would "open the door" to punitive damage claims against insurers in New York:

> Punitive damages will sometimes serve to deter insurer wrongdoing and thus protect insureds from injustice, but they will do so at too great a cost. Insurers will fear that juries will view even legitimate claim denials unsympathetically, and that insurers will thus be exposed to damages without any predictable limit. This fear will inevitably lead insurers to increase their premiums—and so will inflict a burden on every New Yorker who buys insurance.

Five years after the *Bi-Economy* decision, however, the spectre of open-season on insurers raised in Judge Smith's dissent have not been realized. The bar in New York to policyholder claims beyond policy limits have remained substantially intact.

The *Bi-Economy* Decision

The facts underlying the *Bi-Economy* decision are straightforward. Bi-Economy was a meat market in upstate New York. In 2002, Bi-Economy suffered a large fire that forced it to close its entire operation for repairs. Bi-Economy submitted a claim to Harleysville Insurance Co. under its "Deluxe Business Owners" policy, a policy which combined replacement cost coverage for the building and contents with business interruption insurance. Under the terms of the business interruption coverage, Harleysville agreed to "pay for the actual loss of Business Income sustained due to the necessary suspension of [Bi-Economy's] 'operations' during the 'period of restoration.'" "Business income" was defined to include "(1) Net Income (Net Profit or Loss before income taxes) that would have been earned or incurred; and (2) Continuing normal operating expenses incurred, including payroll." The policy defined, "period of restoration" as the period of time that "begins with the date of direct physical loss or damage" and "ends on the date when the property should be repaired, rebuilt, or replaced with reasonable speed and similar quality."

After the fire, Bi-Economy submitted a claim to Harleysville for actual damages and for its business interruption expenses. Harleysville initially agreed to pay only a fraction of Bi-Economy's actual repair-or-replace damage claim. Bi-Economy challenged that amount in alternative dispute resolution and, more than a year later, was awarded an additional sum that was nearly the double of what Harleysville had originally paid on the claim. Bi-Economy also sought 12 months of business interruption expenses from Harleysville, including the time during which the parties disputed the amount of actual damages. Harleysville agreed to pay only 7 months of Bi-Economy's business interruption expenses, despite the fact that its policy provided for 12 months of coverage for such expenses.

The market never re-opened after the fire and Bi-Economy brought a suit in New York state court against Harleysville to recover damages, including consequential damages beyond policy limits to compensate Bi-Economy for the loss of its entire business. Bi-Economy alleged that its business collapsed due to Harleysville's failure to honor the terms of its policy.

Harleysville moved for partial summary judgment to dismiss Bi-Economy's consequential damages claim, citing to the policy's exclusion for "consequential losses." The trial court granted the motion, and the intermediate appellate court affirmed based on the policy exclusion for "consequential losses." The Court of Appeals rejected the reasoning behind the decisions of the trial court and the appellate division, noting that "consequential losses" are those losses which followed from the calamity itself (*i.e.*, the fire in *Bi-Economy*). The Court of Appeals explained that consequential damages, in contrast, are damages "in addition to the losses caused by a calamitous event," and were therefore not subject to the "consequential losses" exclusion. Having clarified that point, the Court of Appeals reversed, holding that Bi-Economy could proceed with its lawsuit seeking consequential damages from Harleysville for the demise of its business, because those damages were reasonably foreseeable and contemplated by the parties, and because Harleysville was charged with having breached its duty of good faith and faith dealing.

Five years on, the fear of the Bi-Economy decision opening the door to a wave of successful bad faith claims have not, thus far, been realized.

In the companion *Panasia Estates* decision (issued on the same day as *Bi-Economy*) the Court of Appeals also recognized the ability of policyholders to recover "consequential damages resulting from a breach of good faith and fair dealing… so long as the damages were within the contemplation of the parties as the probable result of a breach at the time of, or prior to, contracting."

Immediate Reaction to the Bi-Economy Decision

A strongly-worded and lengthy dissent authored by Judge Smith in *Bi-Economy* raised insurer concerns that *Bi-Economy* signaled the erosion of New York's resistance to bad faith and punitive damages and might open the floodgates to potential claims by policyholders for bad faith denial of claims. The dissent stated that the issue of bad faith claims against insurers was already well-settled by the Court of Appeals decisions in *Rocanova* and *NYU v. Continental Insurance Co.* (87 N.Y.2d 309 [N.Y. 1995]), and that the majority decision in *Bi-Economy* "abandon[ed]" the principles set forth in those decisions and "largely nullif[ied]" their holdings.

The dissent reasoned that the majority's decision was permitting punitive damage and bad faith claims by re-labeling those claims: "Punitive damages are now called 'consequential' damages, and a bad faith failure to pay a claim is called a 'breach of the covenant of good faith and fair dealing.'" The dissent also expressed the fear that the consequential damages, left in the hands of a jury, would become a tool to punish insurers, ultimately driving up insurance premiums: "The jurors will no doubt do their best, but it is not hard to predict where their sympathies will lie."

Subsequent Developments

Five years on, the fear of the *Bi-Economy* decision opening the door to a wave of successful bad faith claims have not, thus far, been realized. To date, there has been no expansion of New York law for a stand-alone, separate cause of action for bad faith breach of the insurance contract. In fact, over the past five years, courts have expressly rejected such an expansion of *Bi-Economy*. For example, in *Chaffee v. Farmers New Century Ins. Co.*, 2008 U.S. Dist. LEXIS 74334, at *15 (N.D.N.Y. Sept. 24, 2008), the U.S. District Court for the Northern District of New York held that the policyholder's claim for consequential damages was "properly part of a breach of contract claim and not a separate cause of action." Other courts have similarly rejected broad expansion of the *Bi-Economy* decision. *See*, *e.g.*, *Simon v. Unum Group*, 2009 U.S. Dist. LEXIS 74654 (S.D.N.Y. Aug. 21, 2009) (rejecting policyholder's attempt to recover consequential damages "when there is no showing of a breach of a duty of good faith and fair dealing").

While the "floodgates" may yet open, New York's continuing resistance to bad faith or punitive damages in all but the most extreme circumstances is, in hindsight, unsurprising.

First, the type of coverage at issue in *Bi-Economy*—repair/replacement of premises/contents combined with business interruption—included what the Court of Appeals identified as a "performance-based component." The insurance, the majority stated, offered "peace of mind." At the center of that performance-based component were the insurer's implicit promise to evaluate the claim honestly, adequately and

Tempest in a Teapot (continued)

promptly, and a recognition that its failure to do so would cause additional damages of the very sort that the policy was to protect against.

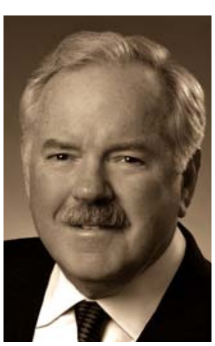
Second, consequential damages claims are narrowly defined under the *Bi-Economy* ruling and may be difficult for policyholders to prove. To recover consequential damages under *Bi-Economy*, a plaintiff must demonstrate (a) the damages were reasonably foreseeable when the contract was formed, *and* (b) that the insurer breached its covenant, implicit in contracts of insurance, of good faith and fair dealing.

Third, the *Bi-Economy* decision did not overrule the long-standing principle of New York law expressed in the Court of Appeals decisions in *NYU* and *Rocanova*, which is that a policyholder still may not pursue a stand-alone punitive damages claim for the breach of an insurance contract unless the plaintiff shows both egregious tortious conduct directed at the insured claimant and a pattern of similar conduct directed at the public generally. Those narrow and high standards remain in place and prevent the types of bad faith claims that are commonplace in other jurisdictions.

What Will Become of the Bi-Economy Ruling and Its Potential Impact on Reinsurers?

The impact of the *Bi-Economy* decision on reinsurers has not yet been reflected in subsequent New York case law. Given the reasoning of the Court of Appeals, consequential damages are a breach of the covered promise, albeit an implicit one, of good-faith and fair dealing, and may therefore be considered a loss covered by reinsurance. To the extent that consequential damage claims do start accumulating under New York law and are then ceded to reinsurers under an extra-contractual theory of liability, coverage will likely turn on the language of any extra contractual obligation ("ECO") clauses in the reinsurance treaties, which typically define coverage for liability that arises from the ceding company's alleged bad faith or negligence in handling of a claim.

Was the storm of criticism and concern directed at *Bi-Economy* a tempest in a teapot? A careful dissection of the majority opinion and the treatment of that opinion by federal and other state courts suggest that it was. ●

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New (semi) Confidential Arbitration Award (cont. from page 29)

2 The leading decision cited for the common law right of public access to judicial documents in *Axa* (and in the cases cited below) is *Lugosch v. Pyramid Co. of Onondaga*, 435 F.3d 110 (2d Cir. 2006), which is not a reinsurance case. Even though the decision is repeatedly relied on by courts denying motions to seal in reinsurance matters, the public interests reviewed by the court in Lugosch – the media's right to review sealed motion papers potentially evidencing graft and corruption by a politically connected real estate developer – are very different than the public interest in reinsurance arbitration awards.

3 *See, e.g., Aioi Nissay Dowa Ins. Co. Ltd. v. Prosight Specialty Management Company, Inc. (f/k/a Mutual Marine Office, Inc.), et al.*, 2012 WL 3583176 (S.D.N.Y. Aug. 21, 2012) (concluding the award, regarding reinsurance dispute arising out of September 11, 2001 attacks, was a judicial document to which the presumption of public access attached and held that the mere existence of a confidentiality agreement was insufficient to overcome, and inconsistent with, the presumption of access.); *Pacific Employers Insurance Company v. Global Reinsurance Corp. of America, U.S. Branch*, No. M-88 (S.D.N.Y. Sept. 2, 2011) (Sullivan, J.) (Part I Judge rejecting request to file documents related to petition to confirm arbitration award under seal); *Pacific Employers Insurance Company v. Global Reinsurance Corp. of America, U.S. Branch,* No. M-88 (S.D.N.Y. Aug. 31, 2011) (Gardephe, J.) (same); *Century Indemnity Co. v. Equitas Ins. Ltd. et al.*, No. 1:11-cv-1034 (S.D.N.Y. Feb. 15, 2011) (Part I Judge rejecting attempt to file petition to confirm arbitration award under seal); *Church Ins. Co. v. ACE Prop. & Cas. Ins. Co.* 2010 WL 3958791, *2-3 (S.D.N.Y. 2010) (denying, without prejudice, reinsurer's request that award arguably filed in violation of confidentiality agreement be sealed); *Mutual Marine Office, Inc. v. Transfercom Ltd.* 2009 WL 1025965, *4-5 (S.D.N.Y. 2009) (denying, without prejudice, reinsurer's motion to seal); and *Global Reinsurance Corporation - U.S. Branch v. Argonaut Ins. Co.* 2008 WL 1805459, *1-2 (S.D.N.Y. 2008) (unsealing reinsurance arbitration awards on cedent's motion for reconsideration of court order sealing same); *see also Harper Ins. Ltd. v. Century Indemnity Co.,* 819 F. Supp. 2d 270, 281 n.15 (S.D.N.Y. 2011) (permitting limited redactions to publicly filed submissions, but rejecting "attempt to use the court system in a private manner"); *OneBeacon Ins. Co. v. Swiss Reinsurance America Corp.*. No. 09-cv-11495 (D. Mass. Nov. 17, 2009) (denying motion to seal petition to vacate arbitration award because "there is a presumption of openness in court proceedings").

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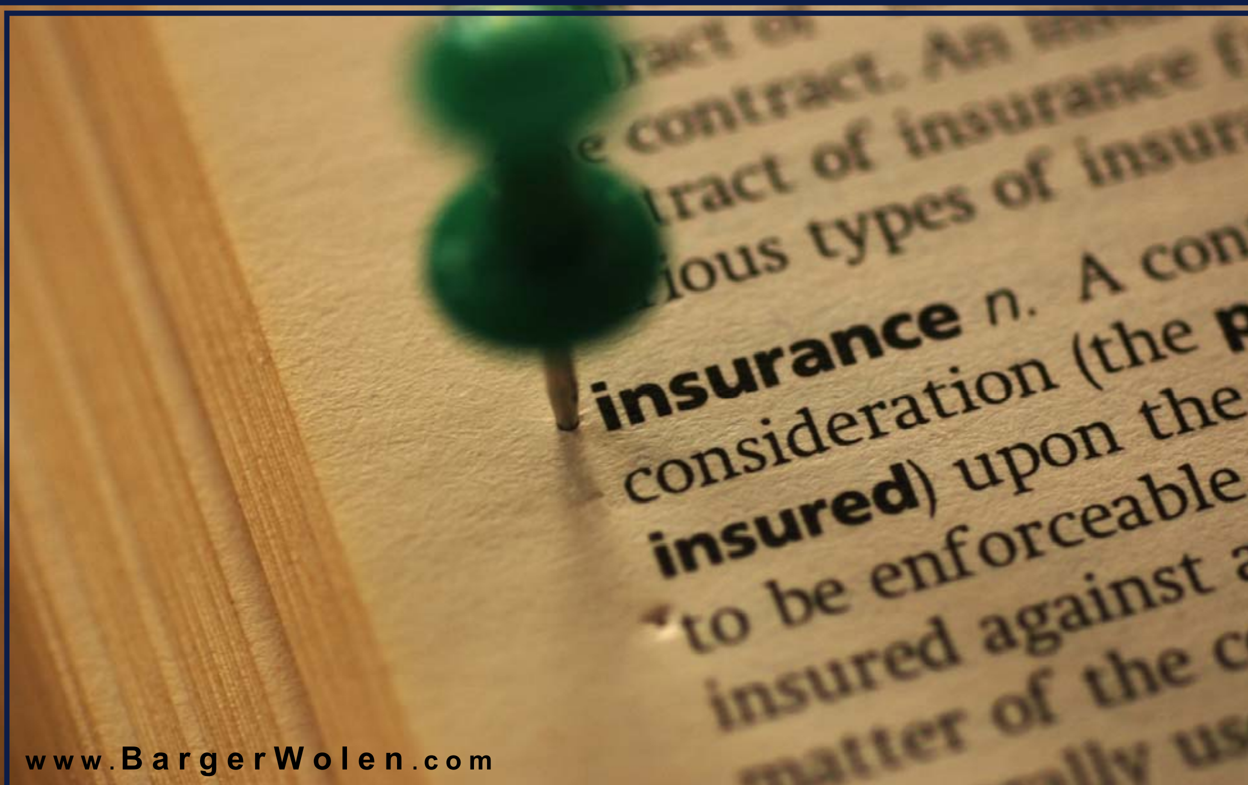

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