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Locke Lord QuickStudy: What Goes Around Comes Around

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In 1990, the Second Circuit in *Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co.*, 903 F.2d ??910 (2d Cir. 1990), affirmed a District Court judgment that reinsurers were not obligated to pay ?additional sums for defense costs over and above the limits of liability specified in a facultative ?reinsurance certificate. Since then, the *Bellefonte* rule acted as a *de facto* cap for both indemnity and ?expense under a facultative certificate. This issue of 'limits' had been hotly contested, and *Bellefonte* ?seemed to put it to rest. ?

BUT NOT SO FAST: After several intervening decisions cast doubt on the continued viability of the ?*Bellefonte* rule, the Second Circuit recently ruled that Bellefonte "no longer constitute[s] the law" of ?the Second Circuit.?

In *Global Reinsurance Corporation of America v. Century Indemnity Company*, No. 20-1476, 2021 WL ??6122136 (2d Cir. Dec. 28, 2021), cedent Century sought reinsurance payments from Global ?Reinsurance under facultative reinsurance certificates. Global filed a declaratory judgment action for ?application of the *Bellefonte* rule – that the stated policy limits of the reinsurance certificates "capped ?Global's reinsurance obligations with respect to both losses and defense costs." *Id*. at *1. The District ?Court applied the *Bellefonte* rule and the holding in *Unigard Security Insurance Co. v. North River ?Insurance Co.*, 4 F.3d 1049 (2d Cir. 1993) to hold in favor of Global.?[1] Century appealed, arguing that ?the reinsurance certificates did not impose a cap on litigation expenses because the certificates ??"were written to be 'concurrent with,' or the same as," the policies that Century issued to its insured, ?which provided that defense expenses were not subject to the policies' limits. *Id*.?

The Second Circuit certified the question to the New York Court of Appeals, and then remanded the ?case to the District Court after the New York Court of Appeals answered that New York law does not ?impose a rule of construction or presumption that "a reinsurance certificate's liability limit caps the ?reinsurer's liability with respect to both indemnity losses and defense costs regardless of whether the ?underlying policy being reinsured is understood to cover defense costs in excess of the policy's ?liability limit." *Id*. at *2. On remand, and after conducting an evidentiary hearing that included ?testimony from six industry experts, the District Court held that the language of the reinsurance ?certificates did not **cap** Global's obligation "to pay its proportionate share of Century's defense costs ?when Century suffers indemnity losses." *Id*. The District Court explained that "concurrent treatment of ?defense costs was incorporated into the certificates through each certificate's 'follow-form' clause, ?which made Global's reinsurance subject to the same terms and conditions of the underlying

?Century policies except as otherwise specifically provided." ?

Upon examination of the reinsurance certificates' "unambiguous language as well as the testimony ?of Century's experts confirming that a strong presumption of concurrency prevailed in the ?reinsurance market at the time the certificates were issued", the Second Circuit affirmed the District ?Court's decision, and acknowledged that *Bellefonte* and *Unigard* "have been undermined" by the ?answer of the New York Court of Appeals.?

Following the Global Reinsurance decision, depending on the wording of a facultative certificate, ?reinsurers may now find themselves at risk of increased exposure to payment of cedents' defense ?costs where the cedent has made an indemnity payment. This decision presents another ?reminder that when negotiating the terms of reinsurance agreements, do not simply accept ?boilerplate wording, but take care to be sure that the 'wording' reflects what both parties intend, ?because you'll never know in advance whether 'what goes around comes around'.?

[1] In Unigard, the Second Circuit applied the Bellefonte rule to conclude that the follow-form clause in a reinsurance certificate "did not ??'override the limitation on liability' and that therefore the reinsurer was not liable for expenses in excess of the liability limit." ?4 F.3d ?at ??1070-71.?

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