Limit of Liability Provisions in Facultative Reinsurance Certificates Are Interpreted under New York Law Using the Standard Rules of Contract Interpretation

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Global Reinsurance Corporation of America v. Century Indemnity Co., __ N.E.3d __, 2017 WL 6374281 (N.Y. Dec. 14, 2017)

Case at a Glance

Reinsurance contracts and underlying property/ casualty insurance policies usually have a stated limit of liability. Underlying policies and reinsurance contracts sometimes provide for the payment of both indemnity for losses and either loss adjustment expenses or defense costs incurred by the insured or the insurer. The question sometimes arises as to whether the limit of a reinsurance contract limits the payment by the reinsurer of both indemnity and expenses, or just indemnity payments, with payment for expenses being outside and in addition to the stated limit of the reinsurance contract. Answering a question certified to it by the United States Court of Appeals for the Second Circuit, the New York Court of Appeals held that there is no presumption or special rule of construction governing this question, but rather that the question should be resolved using standard rules of contract interpretation, with reference to the language of the applicable contracts and any other relevant circumstances.

Summary of Decision

In this opinion, the New York Court of Appeals responded in the negative to a question certified to it by the United States Court of Appeals for the Second Circuit concerning New York law applicable to the interpretation of limit provisions in facultative reinsurance contracts. The Second Circuit certified the following question to the New York Court of Appeals:

“Does the decision of the New York Court of Appeals in [*Excess*] impose either a rule of construction, or a strong presumption, that a per occurrence liability cap in a reinsurance contract limits the total reinsurance available under the contract to the amount of the cap regardless of whether they underlying policy is understood to cover expenses such as, for instance, defense costs?”

Global Reinsurance Corporation of America v. Century Indemnity Co. , 843 F.3d 120 (2d Cir. 2017). In certifying the question, the Second Circuit stated that “[i]f *Excess* imposes a clear rule (or a presumption) with respect to these reinsurance policies, the rule would guide our interpretation of this and substantially similar policies. If, on the other hand, the standard rules of contract interpretation apply, we would construe each reinsurance policy solely in light of its language and, to the extent helpful, specific context.” *Id*. at 128.

In *Excess Insurance Co. Ltd. v Factory Mutual Insurance Co.* , 3 N.Y.3d 577 (N.Y. 2004), New York’s high court held that, under a facultative reinsurance agreement, the reinsurer’s liability was limited to a per occurrence cap, despite the fact that the underlying policy covered expenses, such as underlying defense costs, in addition to indemnity for losses. The precise issue presented in *Essex* was whether the reinsurer’s obligation to pay loss adjustment expenses under an insurance policy that included a follow-the-settlements clause was subject to the stated indemnification limit in the reinsurance agreement. The Court of Appeals held that the limit provision in the reinsurance agreement was all inclusive, and that “[o]nce the reinsurers have paid the maximum amount stated in the [reinsurance] policy, they have no further obligation to pay Factor Mutual any costs related to loss adjustment expenses.” 4 N.Y.3d at 583.

Some courts have interpreted the *Excess* opinion as holding that any facultative reinsurance agreement is unambiguously and presumptively capped by a liability limit in the reinsurance agreement. *E.g., Utica Mut. Ins. Co. v. Munch Reinsurance America, Inc.*, 594 Fed. Appx. 700, 704 (2d Cir. 2014) (“[T]he Court of Appeals arguably ... suggested that a limit of liability, standing alone, is presumptively expensive-inclusive because it serves to cap a reinsurer’s total exposure (for losses and

expenses) at a specific, negotiated amount."). In *Utica Mut. Ins. Co. v. Clearwater Ins. Co.* , 2014 WL 6610915 (N.D.N.Y. Nov. 20, 2014) the court interpreted the *Excess* opinion as holding that "a facultative reinsurance certificate's stated limit provides an overall cap on the reinsurer's liability unless it expressly states that expenses are excluded from the certificate's limit." *Id*. at *3.

In the case giving rise to the certified question, a dispute arose with respect to facultative reinsurance certificates issued by Global Reinsurance Corporation of America ("Global") to Century Indemnity Company ("Century"), which reinsured part of Century's liability under general liability policies that Century had issued to Caterpillar Tractor Company ("Caterpillar"). Century's policies insured Caterpillar for both certain liabilities, which were subject to a loss limit, and for defense costs, which were not subject to the stated loss limit. Caterpillar's losses were in an amount that resulted in Century being liable for the limits of its policies. Century submitted claims to Global under the reinsurance certificates, and a dispute developed as to whether the limit in the reinsurance certificates applied to limit Global's liability to the amount of the limit, or whether the limit applied only to indemnity for losses and not Caterpillar's defense costs.

The Court noted that one of Global's reinsurance certificates, which it quoted as an example, had a "policy limit" of $1 million per each occurrence and a "company retention" which provided that Century retained the first $500,000 of liability for each occurrence, and a "reinsurance accepted" provision which provided that Global assumed, or reinsured, up to $250,000 in excess of Century's retention. The reinsurance certificates did not expressly provide for whether Caterpillar's defense costs were subject the limit of the reinsurance accepted provision of the reinsurance certificates. Century contended that Global was liable for defense costs in excess of the "reinsurance accepted" limit, in part because the reinsurance certificates were subject to the terms and conditions of the underlying policies, and contained a follow-the-fortunes provision.

The district court granted partial summary judgment in favor of Global, holding that the "reinsurance accepted" provision of the reinsurance certificates provided an all-inclusive cap of Global's liability to Century, including both indemnity and defense costs. The district court relied on prior decisions of the New York Court of Appeals and the Second Circuit which had considered the issue in the context of "nearly identical" reinsurance certificates. Century appealed.

On appeal, the Second Circuit found the language in some of the reinsurance certificates involved in the applicable cases unclear, and noted a difference between *Excess*, which addressed the reinsurer's liability for the insurer's expenses, and the situation before it in Global, which concerned the reinsurer's liability for the defense costs incurred by the holder of the underlying policy. Deciding to seek guidance as to this issue of New York law, the Second Circuit certified the question quoted above to the New York Court of Appeals.

The New York Court of Appeals responded to the certified question in the negative, stating that it was dispelling any intimation that *Excess* established a presumption or a *per se* rule of interpretation for reinsurance contracts. The Court stated that it was deciding a "narrow issue," namely that *Excess* did not impose a rule of construction or a strong presumption that a per occurrence liability cap in a reinsurance contract always limits the total reinsurance available under the reinsurance contract, including defense costs. To the contrary, the Court "read *Excess* in harmony with the traditional rules of contract interpretation reiterated numerous times by this Court." Each such dispute, under this ruling, should be decided using the standard rules of contract interpretation, without any special presumptions or rules of interpretation.

The case now returns to the Second Circuit for its disposition.