

Reinsurance Review

Practice Group Update

Is a Reinsurance Liability Cap Inclusive or Exclusive of Defense Costs? New York's Highest Court May Decide

The question of whether a liability cap in reinsurance certificates is cost-inclusive or cost-exclusive is headed to the New York Court of Appeals. On December 8, 2016, the Second Circuit sent a certified question to the court on this issue, explaining that the case presents an "important question of New York law" that the state's highest court has never directly addressed.

The question certified is:

Does the decision of the New York Court of Appeals in *Excess Insurance Co. v. Factory Mutual Insurance Co.*, 3 N.Y.3d 577 (2004), 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 the underlying policy is understood to cover expenses such as, for instance, defense costs?

The issue was raised in an ongoing dispute between Global Reinsurance Corporation of America and Century Indemnity Company over the appropriate liability cap in a series of reinsurance certificates issued by Global to Century's predecessor between 1971 and 1980. The certificates reinsure a portion of Century's liability deriving from CGL policies issued to its insured, Caterpillar, which was sued in thousands of lawsuits alleging bodily injury caused by exposure to asbestos. Century was obligated to reimburse Caterpillar for its liability up to its policies' limits, in addition to Caterpillar's defense costs. After paying, Century sought indemnity from Global pursuant to the reinsurance certificates. Global asserted that a substantial portion of Century's claim constituted defense costs that were capped by the certificates' per-occurrence liability cap. Century claimed defense costs were not capped by the certificates' liability limit. The parties were unable to agree and litigation ensued.

In 2013, Global filed suit in the U.S. District Court for the Southern District of New York. In June 2015, the district court agreed with Global and granted summary judgment in its favor. The court, relying primarily on the Second Circuit's rulings in *Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co.*, 903 F.2d 910 (2d Cir. 1990) and *Unigard Security Ins. Co. v. North River Ins. Co.*, 4 F.3d 1049 (2d Cir. 1993), ruled that the certificates' "Reinsurance Accepted" section unambiguously caps the amount the reinsurer must pay for both "losses" and "expenses" combined. That is, the limit was held to be defense cost-inclusive. Century appealed to the Second Circuit.

 For more information, contact:
Patrick B. Omilian
Michael J. Kurtis
Jeffrey L. Kingsley

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In its order certifying the question, the Second Circuit discussed the purpose of reinsurance as intended to “enable the reinsured to spread its risk of loss among one or more reinsurers,” and that, if the liability cap is “an absolute cap on the reinsurer’s liability for both loss and expenses, then Century’s payments of defense costs could be entirely unreinsured.” The court also noted this “seems to be in tension with the purpose of reinsurance,” and that allowing such an absolute cap on both losses and expenses “could permit Global to receive 50% of the premium while taking less than 50% of the risk.” Four large brokers supported Century as *amici* and argued that continuing to follow the cost-inclusive rule established in *Bellefonte* and *Unigard* could have “disastrous economic consequences” for the insurance industry.

The court agreed these arguments are “worthy of reflection” and, recognizing that this precise issue has never been addressed by New York’s high court, chose to certify the question to the Court of Appeals for a final answer on this important issue of state law. Stay tuned for the final answer as we will continue to monitor and report on this case.

[Read the full decision here.](#)



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