

**SOME MISLEADING INFLUENCES ON THE READING OF  
REINSURANCE CONTRACTS**

*A Plea for Express Intent*

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**I. Introduction**

Reinsurance is a business of transactions that cross national and state boundaries in great numbers and great values measured by premiums, risks and recoveries. It has very old roots as an innovative market free of control by any single nation, responsive to the intentions of parties and governed by the usages and ethical understandings of its principals inherited as part of international commercial practice. It is important that the intentions represented in its contracts be understood in whatever venue they are questioned to the same effect as they were to those who negotiated them. Although this laudable aim will occasionally fail from human error, it should be supported by taking words at their plain meaning to one acquainted with commerce in the place and circumstances of the negotiation and, when they leave meaning unclear, by seeking to understand the business at a practical level, but not to decide according to opinions of what the parties’ judgments should have been, local notions of public policy, disputed

doctrines of substantive interpretation, or considerations of judicial expediency. The increase of reinsurance litigation appears to bring with it an increase in these intrusions.

## II. Character and scope of reinsurance

### A. *Heritage*

Marine insurance, with deep roots in the law merchant (*lex mercatoria*),<sup>1</sup> is regarded as the original field of insurance, in which its business and legal principles were generally formed.<sup>2</sup> Reinsurance, also marine in the beginning, is apparently older than all other types of insurance commercially available except direct marine itself; the earliest recorded instance is said to have been reinsurance on a vessel in 1370 for the more perilous portion of a voyage from Genoa to Sluys.<sup>3</sup> Like its parent, it is rooted in the law merchant. By the late Seventeenth Century, reinsurance was sufficiently common to have statutory recognition in France.<sup>4</sup> Since the 18th Century, learned French commentators<sup>5</sup> as well as English judges and writers<sup>6</sup> have been cited on reinsurance, and marine reinsurance is shown to have existed and been sanctioned over many years in the major commercial nations. With the rise of other classes of direct insurance, reinsurance followed in the Nineteenth Century.<sup>7</sup> Reinsurance, marine and non-marine, has retained, world-wide, much of the doctrine of marine insurance, such as utmost good faith and the treatment of warranties or conditions, unaffected by various local modifications of direct personal lines for the protection of consumers and claimants. Probably nobody

### B. *The Market*

While reinsurance is “insurance”,<sup>8</sup> it is entirely between sophisticated business entities, has no direct connection with consumers and, in many of the intricacies of its variety, has no resemblance to direct policies. Like its marine forbear, the market is generally free. Where reinsurers also participate in the direct insurance market, their solvency and practices in that market are regulated, but the terms of reinsurance itself are historically and actually unfettered, infinitely variable,<sup>9</sup> and frequently artful and loaded with the presumed understandings of the parties.<sup>10</sup> While direct insurers may also write reinsurance and so reinsure each other, of much greater importance in the modern market

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<sup>1</sup> See, e.g., 1 JOHN DUER, *THE LAW AND PRACTICE OF MARINE INSURANCE*, 2-7 (1845).

<sup>2</sup> See, e.g., *Insurance Company v. Dunham*, 78 U.S. (11 Wall.) 1, 31-33, 1997 AMC 2394, 2404-06 (1871).

<sup>3</sup> C. Golding, *The Law and Practice of Reinsurance* 2 (5th ed. 1982).

<sup>4</sup> *Ordonnance de la Marine of Louis XIV* (1681) Title Sixth, art. XX, Appendix, 30 F. Cas. 1211, 1212.

<sup>5</sup> R. Valin, *Nouveau Commentaire sur l'Ordonnance de 1681* (La Rochelle 1766); B. Emerigon, *Traité des Assurances et des Contrats a la Grosse* (Marseilles 1783).

<sup>6</sup> See J. Park, *A System of the Law of Marine Insurance* 315~316; 1 S. Marshall, *A Treatise on the Law of Insurance* 113; 1 Arnould, *Law of Marine Insurance and Average* 270 (16th ed. 1981).

<sup>7</sup> See *In Re Norwich Equitable Fire Assurance Society*, 57 L.T. Rep. 241, 243 (1887) (fire reinsurance for “a great many years past”).

<sup>8</sup> See, e.g., *Feinstein v. Nettlehip Co. of Los Angeles*, 714 F.2d 928 (9<sup>th</sup> Cir. 1983), cert. denied, 466 U.S. 972 (1984) (reinsurers treated as insurers under McCarran-Ferguson Act exemption from antitrust laws).; *Connecticut General Life Ins. Co. v. Johnson*, 8 Cal 2d 624, 67 P2d 675 (1937), rev'd on other grounds 303 U.S. 77 (1938) (reinsurance included in term “insurance” in statute authorizing classes of insurance business); *Carolina Nat. Ins. Co. v. South Carolina Tax Com.*, 256 S.C. 466, 182 S.E.2d 878 (1971) (company providing reinsurance only is included in “insurance companies” exempt from tax).

<sup>9</sup> See generally GRAYDON S. STARING, *LAW OF REINSURANCE*, c. 5 (1992) (hereinafter STARING).

<sup>10</sup> See *id.* § 12:1.

are so-called "professional reinsurers," who engage exclusively in that business, and some other insurers for whom reinsurance is a major part of their business, as it is with many of the syndicates at Lloyd's. Reinsurance companies with great capacity are found in the United States, Europe and the Far East.

The business of reinsurance today freely crosses national and continental boundaries and so national risks are spread around the world. A vast and complex network of reinsurances is generally understood to be essential to the provision of coverage for many of the high values requiring insurance today. "Reinsurance is a global business and plays a critical role in maintaining the financial health of the insurance marketplace and ensuring the availability of property and casualty insurance for U.S. citizens. As of 2008, U.S. insurers ceded reinsurance risks to more than 4,200 reinsurers in 95 jurisdictions outside the United States [and] [n]on-U.S. reinsurers accounted for approximately 53% of the reinsurance written in the United States. "<sup>11</sup> In that year, U.S. premium ceded to offshore reinsurers was about \$58 billion and offshore recoverables were about \$121 billion.<sup>12</sup>

### *C. Disputes*

Historically, most reinsurance disputes not settled amicably have been arbitrated. Most contracts have contained arbitration clauses and still do. And most of the arbitration clauses have called exclusively for arbitrators with substantial executive experience in reinsurance or insurance. As a result most disputes have been decided against a background of practical understanding of the market. Putting aside disputes over arbitration clauses themselves, reinsurance disputes come into the courts where the parties, for whatever reason, have not agreed to arbitrate or the clauses are too narrow to accommodate the issues. The English courts are ordinarily well suited to deal with the business because their commercial judges have learned a good deal of it in practice. Most American judges, however, must either find themselves trapped in the words used or resort to extrinsic evidence of a field in which they have no prior critical background.

Throughout the Nineteenth Century, there were numerous reported American reinsurance cases. Then, for a time, the citations decline. This is not because reinsurance had fallen into disuse; on the contrary, it must have been used on a vastly increasing scale to match increasing values. The decrease in reported litigation was probably due to increasingly sophisticated contracts and the rising acceptance of arbitration. The last few years, however, have seen a great increase in reinsurance litigation, no doubt reflecting the stresses placed on the industry, and on contract terms, by vast losses due to toxic torts and environmental claims.

Anyone who follows the reports of litigation observes that both treaties and facultative reinsurance of larger risks commonly transcend state and national boundaries. The same or similar contracts come into arbitration or litigation in multiple jurisdictions and should reasonably mean the same meanings.

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<sup>11</sup> Letter March 24, 2008 from Reinsurance Association of America to Mr. David Vacca, Senior Financial Analysis and Receivership Manager, Financial Regulatory Services Division, National Association of Insurance Commissioners.

<sup>12</sup> Reinsurance Association of America, *Offshore Reinsurance in the US Market 2008 Data*.

### **III. Subjective Interventions in Reinsurance**

Several tendencies in general contract law and direct insurance law have combined to inject subjectivities into the interpretation of reinsurance contracts. They include a “substantive” school of contract interpretation in conflict with the more formal school, the economic school, mistaken views of ambiguity and misuse of the canon *contra proferentem*, the influence of consumerism in direct insurance, and misconceptions of practice as custom or usage.

#### ***A. Competition of Doctrines.***

There is some tendency in the interpretation of reinsurance contracts to depart from familiar standards of commercial transactions and resort to devices and considerations of little relevance to the business. Some recent decisions appear to introduce notions of public policy, economic theory, judicial convenience or other extrinsic factors of questionable relevance into the interpretation of reinsurance contracts to supplant or supplement the search for the intention of the parties. Apart from its consideration as good contract law generally, this casual practice is especially questionable in a commerce of such wide international and interstate character. At another extreme lies the single-minded grammatical analysis of words and commas limited to the famous “four corners of the contract”. Thus reinsurance contracts are sometimes caught in a contest between very different views of interpretation in general contract law. They sail then perilously between the rock of strict construction and the maelstrom of reconstructive irrelevance. We examine some instances here against the commercial background of the field.

A few issues appear to be most vulnerable to a trend of subjective interpretation. The first and most prominently canvassed in the courts is whether the obligation of reinsurers to follow the settlements of their cedents depends on terms chosen by the parties or an independent doctrine. Another, closely related to it, is whether (or rather perhaps when) the election to follow its settlements should be viewed to include a power of the cedent to allocate losses in its discretion to various reinsurance contracts and periods and, as a subsidiary point, to do so even in disregard of coverage limitations in its own policies. Whether reinsurance is fully congruent with an underlying policy is an issue to which there is likely to be a visceral positive reaction although the terms of coverage differ. The application of notice-prejudice rules is another. All of these will be discussed below.

#### ***B. Formal Interpretation and Plain Meaning Rule***

What is called the formal school of contract interpretation is the one familiar to most common law lawyers for a very long time. Its aim is to discern the intention of the parties by strict grammatical parsing and a set of rules of interpretation and construction emphasizing “plain meaning.” “[U]nless it is obvious that the words are intended to be used in their technical connotation they will be given the meaning that common speech imports.”<sup>13</sup> An interpretation that gives a reasonable and effective meaning to all the

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<sup>13</sup> *Aschenbrenner v. United States Fidelity & Guaranty Co.*, 292 U.S. 80, 85, 54 S. Ct. 590, 78 L. Ed. 1137 (1934); see also RESTATEMENT 2<sup>ND</sup> OF CONTRACTS § 202 (3)(a).

terms is preferred to one that leaves a part unreasonable or of no effect.<sup>14</sup> And such maxims as *eiusdem generis* and *inclusio unius* will be applied where warranted. The parol evidence rule will be applied, and only where meaning cannot be gleaned from plain words will the court turn to extrinsic evidence of intent. “The parol evidence rule aims to ensure some measure of stability in commercial relations. The purpose and essence of the rule is to avoid the possibility that fraud might be perpetrated if testimony as to subjective intent could be substituted for the plain meaning of a contract.”<sup>15</sup>

### ***C. Substantive Interpretation***

#### **1. Generally**

Against the formal school there has arisen a school of substantive interpretation, in which the courts may go behind the words to the context of the transaction and admit evidence of acts, statements, motivations and reliance that the formal school would exclude under the parol evidence rule and standards of relevance. Teachers and writers of the two schools have engaged in lively debate.<sup>16</sup>

Probably the best known contribution to this discussion was Grant Gilmore’s 1974 book with the arresting title, “The Death of Contract”, in which he described elements of contract decisions, such as foreseeability, reliance and expectation, as derived from tort law, and thus arguably exposed the classical analysis of contract doctrine in the law schools to be incorrect as history and principle.<sup>17</sup> A necessary conclusion from that argument was that contract obligations were more dependent on public policy and subjective analysis and less on the authority of parties’ words. Another distinguished professor, recognizing the same trend, acknowledged that it is characterized by vague standards that have the effect of enlarging the scope of judicial regulation and rules of interpretation based on context that limit the ability of parties to control meaning through written agreements and plain language expression” and predict result accordingly.<sup>18</sup>

Others have recognized that the “new contract law” can not be applied equally, or at all, to various classes of contracts, e.g., commercial instruments, complex commercial transactions and specialized markets in which buyers and sellers deal regularly and rely on their rules and practices.<sup>19</sup> Reinsurance is just such a specialized market, commonly a complex commercial transaction, frequently represented by a certificate,<sup>20</sup> a characteristic

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<sup>14</sup> RESTATEMENT 2<sup>ND</sup> OF CONTRACTS § 203 (a).

<sup>15</sup> *Garza v. Marine Transport Lines, Inc.*, 861 F.2d 23, 26, 1989 AMC 228, 233 (2<sup>nd</sup> Cir. 1988).

<sup>16</sup> See Avery W. Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 Columbia L. Rev. 496, 501-06 (2004) (hereinafter Katz) for a brief summary.

<sup>17</sup> GRANT GILMORE, *THE DEATH OF CONTRACT* (1974).

<sup>18</sup> Robert E. Scott, *The Death of Contract Law* (Wright Memorial Lecture), 54 U. of Toronto L.J. 369, 374 (2004).

<sup>19</sup> See Katz, at 503, 510 (“specialized markets”, “commercial specialties ... descending in part from the law merchant”).

<sup>20</sup> See William Hoffman, *Facultative Reinsurance Contract Formation, Documentation, and Integration*, 38 Tort Trial & Ins. Pract.L.J. 763, 809-13 (2003); STARING, § 11:4 (rev. 2005).

commercial instrument, and in any case dependent largely on standard wordings or wordings with history.<sup>21</sup>

Some scholars have expressed the view that “substantive approaches, especially when applied by non-specialist judges operating at a distance from the commercial setting and susceptible to influence by a host of popular and ideological considerations, tend to undermine the certainty of exchange and to defeat the parties’ intentions”.<sup>22</sup> This view is now shared by prominent scholars of the economics school.<sup>23</sup>

## 2. The Economics School

This school is a subset of the Substantive School but sufficiently specialized to have its own identity. In this form of subjectivism the judge displaces the force of words with economic considerations the parties must be supposed to have had in mind. For example, in one Seventh Circuit case, Judge Posner examines the cost of policies as a possible means for the lower court on remand to interpret the policies as excess or primary.<sup>24</sup> In another, he wrote:

Interpreting contracts to make economic sense is a method of contract interpretation that we have commended in other cases [citations omitted] . It rests on the commonsensical observation that people usually don’t pay a price for a good or service that is wildly in excess of its market value, or sell a good or service (here insurance) for a price hugely less than its market value, which would be the case if the cheap vendor’s endorsement bought the kind of coverage that Hartford contends it buys.<sup>25</sup>

This approach led him to conclude that the vendor’s endorsement in issue had an unstated limitation as a matter of reasonable interpretation.

Judge Posner is a brilliant ornament to the bench, and also to insurance jurisprudence because of his remarkable vision of the realities of commerce in that field.<sup>26</sup> But should his grasp of economic realism in this field lead him to enter the minds and reconstruct the intents of those who act in it? It is after all a part of the economics of the setting that large corporations with large liability exposures have risk managers who supervise their insurance programs. The judge’s economic views may be good general advice but not a basis for deciding what is meant by the contract the risk manager makes. He is presumably guided by experience and direct knowledge of his company’s business

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<sup>21</sup> See STARING, §§ 12:1, 12: 4 (rev. 2006).

<sup>22</sup> Katz, at 501 (referring to Professor Samuel Williston, Judge Learned Hand and Professor Richard A. Epstein).

<sup>23</sup> See, e.g., Katz, at 504 (“many common contractual devices are designed as responses to the fact that generalist courts cannot effectively ... determine the facts necessary to enforce the parties’ substantive bargain as they ideally would wish it to be enforced in a world of full and free information. For courts to ignore these limitations ... disserves the parties’ bargain”; citing Professors Robert E. Scott and Alan Schwartz) .

<sup>24</sup> Rhone-Poulenc Inc. v. International Ins. Co., 71 F.2d 1299 (7<sup>th</sup> Cir. 1995).

<sup>25</sup> Hartford Fire Ins. Co., v. St. Paul Surplus Lines Ins., 280 F.3d 744, 747-48 (7<sup>th</sup> Cir. 2002).

<sup>26</sup> See generally Jeffrey W. Stempel, *An Inconsistently Sensitive Mind: Richard Posner’s Cerebration of Insurance Law and Continuing Blind Spots of Economicalism*, 7 CONN. INS. L.J. 7, 11-41(2000-2001).

and should be considered to have a higher understanding than the judge of the risks involved. And there is also an underwriter at the other end of the stick, the crux of whose business judgment is estimate of risk and suitable words to describe it.

#### ***D. Ambiguities and the Canon Contra Proferentem***

##### **1. Generally**

“Ambiguous” is frequently misused to describe a passage that is at first difficult to understand. Ambiguity (going two ways) literally denotes the existence of more than one meaning, rather than simple obscurity, that is, the difficulty of finding a meaning. Some courts are stricter than others in the use of the term; or in discriminating between these uses. This affects whether and how the canon *contra proferentem* may be applied. The canon may govern the choice between reasonable meanings, but if interpretation of the obscure wording does not produce two reasonable meanings, there is no such choice.<sup>27</sup>

The Court of Appeals for the Second Circuit is one that has treated ambiguity in its proper sense. In a dispute between excess insurers, it frames this definition (quoting from earlier decisions):

[a] word or phrase is ambiguous when it is capable of more than a single meaning "when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business." <sup>28</sup>

The court described the canon as "a matter of last resort" and held it inapplicable in a contest between insurance companies. Holding that extrinsic evidence could be received to resolve ambiguity in an integrated contract, the court examined the broker's binder, which made the intent quite clear, and the minutes of the insured's board, which confirmed it.

The fact that an ambiguity is resolved by thoughtful interpretation and construction does not mean that it cannot also be reasonably misunderstood. This is illustrated in two intimately related decisions by an English court with the same understanding of ambiguity as that of the Second Circuit. The problem was whether reinsurance "in respect of risks attaching for periods as original (up to but not exceeding 48 months)" referred to the time of attachment of the underlying policy or la period after its attachment, in which case the reinsurance had expired before the loss occurred, more than 48 months later. The judge decided by careful parsing of the sentence that the time had expired, and said: "I do not find the issue simple. It involves construing a single sentence, 15 lines long, the grammatical structure of which is far from clear."<sup>29</sup>

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<sup>27</sup> See *British Int'l Ins. Co. v. Seguros La Republica, S.A.*, 342 F.3d 78 (2<sup>nd</sup> Cir. 2003) (proponent of ambiguity has burden of showing two meanings).

<sup>28</sup> *U.S. Fire Ins. Co. v. General Reinsurance Corp.*, 949 F.2d 569, 572 (2<sup>nd</sup> Cir. 1991); *British Int'l Ins. Co. v. Seguros La Republica, S.A.*, 342 F.3d 78, 82 (2<sup>nd</sup> Cir. 2003) (same as *U.S. Fire*); see *Allstate Ins. Co. v. Administratia Asigurarilor De Stat*, 948 F. Supp. 285 (S.D.N.Y. 1996) (treaty provision found unambiguous).

<sup>29</sup> *Youell v Bland Welch & Co.* [1990] 2 Lloyd's Rep 423, 427 (Q.B. Comm. Ct. 1990), aff'd, [1992] 2 Lloyd's Rep 127 (C.A. 1992).

He next dealt with the reinsureds' claim against their brokers for failing to explain the purpose of the words and so allowing them to suppose that the time of attachment was meant and they were still covered after 48 months. The brokers argued that the clause was not ambiguous because the judge had succeeded in reading it, but he said: "The 48 month clause is unquestionably ambiguous. . . As is clear from my interim judgment I found the task of construction a difficult one."<sup>30</sup> The canon is a potential labor-saving device that can obviate the hard work of serious interpretation and construction. Some courts are obviously more assiduous than others in pursuing that difficult task.

The canon contra proferentem will decide a stubborn ambiguity against the party responsible for its uncertainty, if that responsibility can be definitely traced. If there is occasion to apply it to such a commercial contract as reinsurance, it must be in circumstances of desperation and when the responsibility for the ambiguity has been proven. The majority view is that the canon is inappropriate to reinsurance in any case.<sup>31</sup> Another view is that it is at least inappropriate when negotiation and joint drafting are shown.<sup>32</sup> Occasional decisions can also be found to apply it flatly against the reinsurer,<sup>33</sup> or against the reinsurer unless the reinsured drafted the ambiguous provision (without indication that it would then be applied against the reinsured),<sup>34</sup> or against the reinsured when it did in fact draft the contract.<sup>35</sup> It should be fairly obvious that the common policy of interpreting "consumer" policies in favor of the insureds has no proper use in reinsurance.

It is inappropriate, not merely because one party is not socially preferred as a "consumer", but because, whoever initially wrote a word or phrase, both may be

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<sup>30</sup> Youell v Bland Welch & Co., [1990] 2 Lloyd's Rep 431, 440 (Q.B. Comm. Ct. 1990), *aff'd*, [1992] 2 Lloyd's Rep 127 (C.A. 1992).

<sup>31</sup> Unigard Security Ins. Co. v. North River Ins. Co., 4 F.3d 1049, 1065 (2<sup>nd</sup> Cir. 1993) ("canons of construction that protect individual purchasers of original insurance policies do not apply to reinsurance"; "reinsurers are so dependent upon ceding insurers for information, that application of a canon construing the reinsurance contract against the reinsurer would be highly anomalous"), *British Ins. Co. of Cayman v. Safety Nat. Cas. Corp.*, 146 F. Supp.2d 585 (D.N.J. 2001), *rev'd on other grounds*, 335 F.3d 205 (3<sup>rd</sup> Cir. 2003); *Continental Casualty Co. v. Certain Underwriters at Lloyd's*, [1993] Lloyd's Rep IR (2 Re LR) 280 (N.D. Cal. 1993); *In Re Pritchard & Baird, Inc.*, 8 B.R. 265 (D.N.J. 1980), *aff'd without op.* 673 F.2d 1299 and 673 F.2d 1301 (3<sup>rd</sup> Cir. 1981); *Vera Democrazia Soc. v Bankers' Nat. Life Ins. Co.*, 10 N.J. Misc. 632, 160 A. 767 (1932); *see Affiliated FM Ins. Co. v. Constitution Reinsurance Corp.*, 416 Mass. 839, 626 N.E.2d 878 (1994) (canon "must give way to the primary objective that a contract is to be construed to reflect the intention of the parties" and case remanded for consideration of usage); *but cf. Employers Mut. Liability Ins. Co. v. Underwriters at Lloyd's*, 177 F.2d 249 (7<sup>th</sup> Cir. 1949) (canon applied to reinsurer, because contract followed form on underlying policy, to which canon applied).

<sup>32</sup> *Northbrook Excess & Surplus Ins. Co. v. Proctor & Gamble Co.*, 924 F.2d 633 (7<sup>th</sup> Cir. 1991); *see Commercial Union Ins. Co. v. Seven Provinces Ins. Co.*, 9 F. Supp. 2d 49 (D. Mass. 1998) (certificate made up by MGA of several forms from different sources not to be charged to reinsurer), *aff'd*, 217 F.3d 33 (1<sup>st</sup> Cir. 2000); *Minnesota School Boards Ass'n Ins. Trust v. Employers Insurance of Wausau*, 331 F.3d 579 (8<sup>th</sup> Cir. 2003) ("rule would seem to have less force. . . [where] insured is a business represented by lawyers and an insurance broker" but Minn. law apparently contrary).

<sup>33</sup> *Royal Ins. Co. v. Vanderbilt Ins. Co.*, 102 Tenn. 264, 52 S.W. 168 (1899); *see Christiania General Ins. Corp. of New York v. Great American Ins. Co.*, 979 F.2d 268 (2<sup>nd</sup> Cir. 1992) ("an ambiguous reinsurance contract is generally construed against the reinsurer"), *disapproved*, Unigard *supra* note 31.

<sup>34</sup> *Bryson v. Guarantee Reserve Life Ins. Co.*, 520 F.2d 563 (8<sup>th</sup> Cir. 1975); *Security Mut. Casualty Co. v. Century Casualty Co.*, 531 F.2d 974 (10<sup>th</sup> Cir.), *cert. denied* 429 U.S. 860, 97 S. Ct. 161, 50 L. Ed.2d 137 (1976); *see Justice v. Stuyvesant Ins. Co.*, 265 F. Supp. 63 (S.D. W. Va. 1967).

<sup>35</sup> *London Assurance Corp. v. Thompson*, 170 N.Y. 94, 62 N.E. 1066 (1902).

presumed to have adverted to it and approved it. A judge may not be able to "unscrew the inscrutable;" and the result of invincible inscrutability must depend on the burden of proof of extraneous evidence introduced to construe the contract. It is fair to add that the economic evidence deplored above as a means of subverting plain words may be appropriate at this point relevant to the more reasonable of two interpretations. The conclusion will result from the combination of logic and factual evidence that can be respected from state to state and nation to nation, without dependence on local procedural rules, evidentiary presumptions, or social policies.

## 2. Silence and Presupposition as Ambiguity

Some of the decisions of the Economics School cited above can be seen as variants of ambiguity, in which the alternative "interpretation" creating ambiguity is not derived from the contract words but from the extrinsic source of economic realism, put forward as a "reasonable understanding" of the words. In those cases the word "ambiguity" is not used. Somewhat analogous, although more extreme in concept, are those cases in which the absence of a following settlements clause or explicit denial of any is taken to raise a question that can be answered by testimony as to what is usual.

Two recent cases present these devices explicitly as exercises in ambiguity. The insurer settled claims of workers for injurious exposure to fluids used in machine shops. The reinsurer relied on a broad pollution exclusion, comprehending "contamination of any environment by pollutants that are introduced at any time, anywhere, in any way" and "[a]ny bodily injury, [or] personal injury ... arising out of such contamination", with "Contamination", "environment" and "pollutants" each defined very inclusively. Applying Ohio law, the court decided that the exclusion was too broad and not sufficiently specific to apply to the facts.<sup>36</sup>

In so deciding that the greater should not include the lesser, the court quoted from a decision of the Ohio Supreme Court expounding a standard of specificity and holding a broad pollution exclusion inapplicable to inhalation of carbon monoxide.<sup>37</sup> The Ohio court said that pollution exclusion clauses had been used historically to avoid the "enormous expense and exposure resulting from the 'explosion' of environmental litigation," and that the exclusion should not be applied to situations that "do not remotely resemble traditional environmental contamination."<sup>38</sup> The New York court declared similarly that the underlying lawsuits before it "were not a result of traditional environmental pollution", citing an affidavit apparently of an employee of the reinsured.<sup>39</sup> Then, based on the purported purpose of the exclusion stated in the Ohio case, the reinsured's expectation of coverage was declared reasonable, "[b]ased on the traditional understanding of pollution exclusions."<sup>40</sup> The court declared the clause ambiguous because of its generality, and explained its ecto-ambiguity this way:

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<sup>36</sup> National Union Fire Insurance Co. of Pittsburgh, Pennsylvania v. American Re-Insurance Co., 351 F. Supp.2d 201 (S.D.N.Y. 2005).

<sup>37</sup> *Id.* at 209.

<sup>38</sup> Anderson, Admr. v. Highland House Company *et al.*, 93 Ohio St.3d 547,551-52,757 N.E.2d 329, 334 (2001) (internal quotations omitted).

<sup>39</sup> National Union Fire Insurance Co. , *supra* note 36, at 211.

<sup>40</sup> *Id.*

Ambiguity is created because the pollution exclusion could reasonably be understood by National Union in two different ways: First, in the traditional understanding that pollution exclusion clauses only exclude coverage for traditional environmental pollution; (citation to Ohio decision omitted) and second, in a literal, but broader, understanding that would exclude coverage for any range of injuries or damages.<sup>41</sup>

This agile sidestep was accomplished by raising “traditional” views or actions to a new and unfounded legal significance (discussed below) and extending the concept of contractual ambiguity explicitly beyond the contract.

### ***E. Custom, Usage and Tradition***

Custom and usage are often referred to in connection with interpretation of reinsurance contracts, often mistakenly and in tandem. This subject is well and thoroughly discussed by William Hoffman in a well-circulated, scholarly article.<sup>42</sup> A common law custom “must, in order to be valid, be ancient, reasonable, and generally known ... and also be certain ...”<sup>43</sup> No such custom can be found in reinsurance beyond the international custom *pacta sunt servanda*.

Usage is undoubtedly sometimes important in reinsurance, but rather too often confused with mere business practices that are not legally obligatory. The Second Circuit, citing authorities grounded in the common law, has said: [A] trade usage must be “so well settled, so uniformly acted upon, and so long continued as to raise a fair presumption that it was known to both contracting parties and that they contracted in reference thereto” (Citation omitted).<sup>44</sup> The force of trade usage is limited to the community or market in which it is proved to obtain<sup>45</sup> and must be proved to obtain in the community where it is sought to be applied.<sup>46</sup> Considering its definition, usage is obviously negated by the presence of serious disagreement within a trade or industry as to its existence.

I deal with tradition here together with custom and usage, not because it deserves their respectable company, but because it is best treated by contrast to them. Who proves tradition? Does tradition bind anybody? Let us see.

Tradition as a norm is perplexing and unlikely ever to be otherwise. While the word refers to practice, it does not connote the uniform acceptance or compulsion of usage or custom, or the required longevity of the one or antiquity of the other. Tradition is a portmanteau word, with many and various sociological uses, ranging from undocumented history and old lyrics or sayings to family holiday dinners, and has almost

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<sup>41</sup> *Id.*

<sup>42</sup> William Hoffman, *On the Use and Abuse of Custom and Usage in Reinsurance Contracts*, 33 TORT & INS. L.J. 1 (1997), [1998] LLOYD’S MAR. & COM. L.Q. 43 (1998).

<sup>43</sup> *United States v. Buchanan*, 49 U.S. (8 How.) 83, 102, 12 L. ed. 997 (1850).

<sup>44</sup> *British Int’l Ins. Co. v. Seguros La Republica, S.A.*, 342 F.3d 78, 83-84 (2<sup>nd</sup> Cir. 2003).

<sup>45</sup> Uniform Commercial Code § 1-205, 1 U.L.A. 123 (1989).

<sup>46</sup> *Insurance Co. of North America v. Hibernia Ins. Co.*, 140 U.S. 565, 11 S. Ct. 909, 35 L. Ed.517 (1891).

no recognition in law. Only one of the two major legal encyclopedias attempts to define it, and then only to make clear that it has no evidentiary significance beyond possibly family practices and historical facts.<sup>47</sup>

There is not much literature about the nature of tradition. We find one book that records “traditions” invented for political or social purposes.<sup>48</sup> The editors and authors were concerned mainly with political and anthropological traditions but a passage from the introductory chapter describing invented tradition exposes the malleability of the word and indefiniteness of its content:

“Invented tradition” is taken to mean a set of practices, normally governed by overtly or tacitly accepted rules and of a ritual or symbolic nature, which seek to inculcate certain values and norms of behaviour by repetition, which automatically implies continuity with the past. In fact, where possible, they normally attempt to establish continuity with a suitable historic past.... However, insofar as there is such reference to a historic past, the peculiarity of 'invented' traditions is that the continuity with them is largely fictitious. In short, they are responses to novel situations which take the form of reference to old situations, or which establish their own past by quasi-obligatory repetition.<sup>49</sup>

The oxymoronic “invented tradition” describes such commonplace observances now as Fathers Day and others created to market cards and gifts.

Thus “traditions” may be no older than last year. Where did those mentioned start? The invention of “traditional environmental pollution” can be traced through the Ohio Supreme Court’s citation<sup>50</sup> to an opinion in Illinois<sup>51</sup> on the escape of carbon monoxide from a broken furnace, where in context “traditional” meant nothing more than “with which we are acquainted”. From “traditional environmental pollution” it appears to have metastasized to “traditional understanding” as those terms were finally joined in the New York court’s finding of ambiguity.<sup>52</sup> With whom is environmental pollution traditional? In what business or culture is it traditional to believe in contract benefits without reading the words of the contract? Does anyone lay claim to these traditions?

### ***F. Judicial Expediency***

From the judicial point of view urged by advocates of clients who will benefit from it, some clauses and readings are unquestionably more expedient than others, as obviating extended litigation. One would not expect this *ratio decidendi* to be quite

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<sup>47</sup> See C.J.S. EVIDENCE § 284 (not sufficiently probative to warrant inference of truth, with very limited exceptions).

<sup>48</sup> ERIC HOBBSBAWN & TERENCE RANGER (EDS.) THE INVENTION OF TRADITION (Cambridge 1992), *see esp.* ch. 2 by Hugh Trevor Roper, *The Highland Tradition of Scotland*, describing the manipulation of fancy dress by “literary ghosts, forged texts and falsified history” (p. 41).

<sup>49</sup> *Id.* at 1.

<sup>50</sup> Anderson, Admr., *supra* note 38, at 551-52.

<sup>51</sup> American States Ins. Co. v. Kolums, 177 Ill. 473, 493, 687 N.E.2d 72 (1997) (auto exhaust insufficiently traditional).

<sup>52</sup> National Union Fire Insurance Co., *supra* note 36, at 211.

explicitly acknowledged and it isn't. It is, however, highly inferable, and indeed visibly operating, in some instances. One is a case where the district court in a well-reasoned opinion refused to validate allocations of settlement losses to reinsurers routinely under the following settlements clause and the court of appeals reversed on the strength of a recent decision affirming such validation under very different circumstances and without any attention to the district judge's reasons for rejecting it and for distinguishing the very case relied on to reverse her.<sup>53</sup> Other instances are to be found among the decisions discussed below that following settlements does not require the parties' agreement in the form of a clause (obviating trial of the propriety of the settlement) and decisions that reinsurance written in different words is presumed nevertheless to be exactly congruent with the underlying policy (obviating the effort to analyze the differences).

#### **IV. Effects on Reinsurance Issues: Neglect of Parties' Intentions**

##### **A. Following Settlements**

The indemnity obligation of a reinsurer is its actual legal liability under its contract and the underlying policy.<sup>54</sup> The liability arising from the underlying policy, if questioned, is put out of doubt by a final judgment or award. A settlement with the insured, without more, leaves that element of liability open to dispute. For this reason reinsurance contracts often contain a "follow the settlements" clause in one of a number of forms. They are variously qualified and not all of the same scope. Their purpose is to bind the reinsurer to reasonable settlements made by the reinsured in good faith within the terms of the clause and eliminate the need for the reinsured to defend a claim to judgment.<sup>55</sup> They appeared in American jurisprudence when first Chief Justice Kent<sup>56</sup> and then Justice Story<sup>57</sup> reported their use in France and explained the consequences when they are used or not used in a contract. In the words of a reinsurance underwriting executive and scholarly writer: "a 'follow the settlements' clause is a bargained-for enhancement to and modification of the traditional indemnity obligation and is neither necessary nor in every case desired."<sup>58</sup> The clause appears with various qualifications<sup>59</sup> and in the course of bargaining the reinsurer's agreement to it is presumably based on a premium and his confidence in the integrity of the reinsured.

In several cases courts have mistaken the following of settlements to be a doctrine implied or inherent in the reinsurance contract in the absence of any clause, like Holmes' "brooding omnipresence in the sky."<sup>60</sup> They are persuaded sometimes by testimony that it

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<sup>53</sup> *Travelers Cas. & Surety Co. v. Gerling Global Reinsurance Corp. of America*, 419 F.3d 181 (2<sup>nd</sup> Cir. 2005), rev'g, 285 F. Supp.2d 200 (D. Conn. 2003).

<sup>54</sup> *See, e.g.*, Cal. Ins. Code § 621.

<sup>55</sup> *See generally*, STARING, Chapt. 18 (rev. 2007).

<sup>56</sup> *Hastie v. De Peyster*, 3 Cai. R. 190, 1805 WL 785 (N.Y. Sup. 1805).

<sup>57</sup> *New York State Marine Ins. Co. v. Protection Ins. Co.* 1 Story 158, 18 F. Cas. 160 (No. 10216) (C.C.D. Mass. 1841)

<sup>58</sup> William Hoffman, *Facultative Reinsurance Contract Formation, Documentation, and Integration*, 38 *Tort Trial & Ins. Pract.L.J.* 763, 820 (2003)

<sup>59</sup> *See* R. Michael Cass, *Quota Share* in ROBERT W. STRAIN (ED.) *REINSURANCE CONTRACT WORDING* 111, 130-32 (rev. ed. 1996).

<sup>60</sup> *Southern Pacific Co. v. Jensen*, 244 U.S. 205, 222, 37 Sup. Ct. 524, 61 L. Ed. 1086, 1996 AMC 2076, 2088 (1917).

is a usage (often miscalled a custom).<sup>61</sup> Such a usage could only exist if it were “fixed and invariable” and “uniformly acted upon” in the trade<sup>62</sup> and following settlements clearly is not so, as the quotation above and other statements readily available show.<sup>63</sup> There may be here also an element of judicial expediency, encouraged by Story’s statement that the clauses were used by the French “to avoid . . . inconvenience and delay”,<sup>64</sup> in which he was probably not referring to the convenience of the courts. This trend was checked somewhat when the Ninth Circuit reversed itself and the lower court by ruling that any assertion of such a usage would have to be tried as a fact.<sup>65</sup> But even in dealing with contracts actually containing follow the settlements clauses the notion of following settlements as a doctrine persists in some courts’ molding of “doctrine” instead of seeking the parties’ intentions in the wording of the available clause. The extended litigation from the mid-19<sup>th</sup> to the late 20<sup>th</sup> centuries over the relative scope of various following settlement clauses is inconsistent with the notion that none of them were needed to begin with.<sup>66</sup>

### ***B. Allocations as a feature of following settlements***

Proliferation of environmental and toxic substance claims has made allocation issues a familiar subject by itself. While similar issues in simpler cases have been resolved as questions of coverage under the contract sought to be charged, global lump-sum settlements of numerous claims present greater problems and lead to a number of allocation patterns, the variety of which is discussed elsewhere.<sup>67</sup> A proposed allocation may be rejected for having no foundation in the negotiation or other circumstances of the settlement.<sup>68</sup>

Conversely, when negotiations of the reinsured have been directed to settling amounts at risk under particular policies rather than in gross, the allocation may be inherent in the settlement, but such inherency cannot be lightly assumed. A reasonable test proposed by experienced writers and speakers in the field is "that [the following settlements clause] should apply only if the allocation decision was necessarily and genuinely part of the claims settlement process." They explain that this comports with the principle of issue preclusion that binds non-parties only where a case was litigated at arms length by a party with a genuine interest in protecting the positions of the non-party, and that "[u]nless this requirement is met, application of [following settlements] is merely

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<sup>61</sup> See, e.g., *International Surplus Lines Ins. Co. v. Certain Underwriters & Underwriting Syndicates at Lloyd’s of London*, 868 F. Supp. 917 (S.D. Ohio 1994) (summary judgment based on reported evidence of “custom” in another case later reversed); *Aetna Casualty & Surety Co. v. Home Ins. Co.*, 882 F. Supp. 1328 (S.D.N.Y. 1995) (on unfounded testimony of “custom”).

<sup>62</sup> *British Int’l Ins. Co. v. Seguros La Republica, S.A.*, 342 F.3d 78 (2<sup>nd</sup> Cir. 2003).

<sup>63</sup> William Hoffman, *supra* note 58, at 820 and n. 196; see STARING § 18:2 (rev. 2007) for further discussion.

<sup>64</sup> *New York State Marine Ins. Co.*, *supra* note 57, at 160.

<sup>65</sup> *National American Ins. Co. v. Certain Underwriters at Lloyd’s, London*, 93 F.3d 529 (9<sup>th</sup> Cir. 1996).

<sup>66</sup> See STARING, § 18:4 (rev. 2007) (*Historical development of loss settlement clauses*).

<sup>67</sup> See STARING § 17:5 (rev. 1999).

<sup>68</sup> See, e.g., *Employers Reinsurance Corp. v. Newcap Ins. Co., Ltd.*, 209 F. Supp. 2d 1184 (D. Kan. 2002) (allocation to reinsured CGL policy rather than unreinsured professional liability policy); *Hartford Acc. & Indem. v. Columbia Cas. Co.*, 98 F. Supp. 2d 251 (D. Conn. 2000) (allocation of cost of environmental losses at 50 sites to occurrence at single site where “sudden and accidental” event could be identified).

a fiction." Thus, the answer to the question whether the allocation was necessarily and genuinely part of the claims settlement process

is found by examining the insured's interest in the allocation at issue. Simply stated, where an insured's interest in an allocation of liability is lacking, a settlement with the insured regarding the allocation would not have been necessary and correspondingly not subject to a [following settlements] clause.<sup>69</sup>

They point out that an insured is not in privity with the reinsurer<sup>70</sup> and therefore will rarely have the necessary identity of interest to protect the reinsurer's position. One may wonder at first why the very identity of interest of the cedent with the reinsurer which underlies the following settlements clause would not be sufficient. But that interest no longer operates in allocations of loss as it does in limiting the amount of loss, because at the point of allocation the interests of the cedent and some of the reinsurers have become adverse. Were it not so, contests over allocation would be unlikely to occur.

The conventional view that the following settlements clause derives its scope from the intention of the parties ought to lead to a cautious application of the clause to allocations. A very different view is that following settlements is a usage somewhat vaguely defined that exists without mention in the contract, the malleability of which leads to an assumption based on convenience and judicial economy that, not only the cedent's settlements are to be followed, but also its allocations. The view that the following settlements "doctrine" is not dependent on the parties' stated intentions has been discussed above and is unfounded.<sup>71</sup>

Settlement and allocation are far from synonyms. Allocation is, however, implied in the settlement when it is actually inherent in it, as explained above. "Settlements," as used in the clause, might also include such allocations by an understanding of the parties, evidenced either by words or by practical construction. The few cases that most prominently deal with the controversy over the conceptual inclusion of allocations in settlements approach the question from different premises as to the importance of the following settlements clause, its intended purpose and the existence of a usage independent of it. Allocations have been declared inseparable from settlement in some prominent cases that were unfortunate choices for decision on this point because the reinsurer's bad faith and the reinsured's proofs of reasonableness made the following settlements clause superfluous.<sup>72</sup>

It may be superficially plausible to say that determining which policies cover a loss is not much different from deciding that the losses are covered by the policies as a whole. It amounts in result, however, to saying that, if a loss is covered by one of the

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<sup>69</sup> David R. Gross, Joseph J. Schiavone and Kevin Helewa, Allocation and Reinsurance, in CONTEMPORARY REINSURANCE AND EXCESS INSURANCE ISSUES 3, 10-11 (Glasser 1996).

<sup>70</sup> See STARING § 16:2 (rev. 1999).

<sup>71</sup> See STARING § 18:2 (ref. 2007).

<sup>72</sup> E.g., Commercial Union Ins. Co. v. Seven Provinces Ins. Co., Ltd., 9 F. Supp. 2d 49 (D. Mass. 1998), aff'd, 217 F.3d 33 (1<sup>st</sup> Cir. 2000) (but allocation's reasonableness and reinsurer's bad faith also shown); North River Ins. Co. v. ACE American Reinsurance Co., 361 F.3d 134 (2<sup>nd</sup> Cir. 2004) (but allocation supported by reinsured's careful pre-settlement risk analysis).

policies, the cedent is at liberty to assign it to any or all of them, regardless of the distinction of reinsurers of the several policies. This cannot be reconciled with the settled right of a reinsurer to insist, regardless of a following settlements clause, that the loss he is to pay be actually within the subject matter of the underlying policy he reinsured.<sup>73</sup> Indeed it is not enough that a reinsured actually paid a loss under a policy to which he allocated it with the reinsurer; anyone who assumes that reinsurance is never shrewdly taken into account by the reinsured in paying claims under a policy well reinsured, rather than the policy that would properly have covered it, should note the criminal conviction of an insurance manager who, having two policies issued to the same insured, settled a large loss nominally and improperly under the one more liberally reinsured.<sup>74</sup>

### ***C. Congruency***

By congruency I mean identical coverage of subject by the reinsurance and direct insurance. Under pro rata treaties it must always exist, absent some qualifying clause. But this is not so of excess of loss treaties, in which congruency is no doubt usually but often not intended. Where the wordings are the same or the reinsurance follows form without qualification, it should be difficult to contend for different meanings, but not at all so when the wordings vary. Variant wordings are unlikely in basic coverage but occur in aggregation clauses combining related losses as a single loss for the purpose of limits and retentions. Such relationships are commonly based on the origination of the losses in a single event or a single cause.

It is intuitive for courts to presume that back-to-back coverages are simply congruent, and to incline toward a strained interpretation of one or the other or treat the difference as a mistake tending to defeat the obvious intent of the parties. But “event” and “cause” are not synonyms. The former refers to something that happens at some particular place and time, while “cause” has a much broader aggregating effect because “it can be a continuing state of affairs; it can be the absence of something happening,” as Lord Mustill said for a unanimous panel, where he described the considerations that might lead an underwriter of the reinsurance to prefer to deal with events rather than causes. As he also said, “the only safe course is to fall back on the words actually used and to read them as they stand.”<sup>75</sup>

### ***D. Notice and prejudice rules***

Another situation of interest is found in the notice-prejudice rules in respect of timely notice of claims. Reinsurance contracts ordinarily require prompt notice of threatened loss. Events or conditions requiring notice and starting the time running give rise to many disputes and we are concerned here only with the existence and operation of rules requiring the reinsurer to show not only breach but prejudice as a defense to a claim.

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<sup>73</sup> See STARING §§ 18:5, 18:6 (rev. 2007).

<sup>74</sup> *United States v. Brennan*, 938 F. Supp. 1111 (E.D.N.Y. 1996), rev’d on ground of improper venue, 183 F.3d 139 (2<sup>nd</sup> Cir. 1999).

<sup>75</sup> *Axa Reinsurance v. Field*, [1996] 2 Lloyd’s Rep. 233, 238-40 (H.L. 1996).

Where serious breaches are found, the laws of some states routinely treat the notice as a condition precedent to payment regardless of prejudice<sup>76</sup> and others do not but express or imply that they will do so if the contract is explicit that a condition is intended.<sup>77</sup> There is much to be said for stating conditions as such and what is troublesome is the subjective disparity in otherwise dealing with prejudice.

Where the contract requires timely notice it probably also reserves some right of association or approval in the defense and settlement of a claim. Timely notice may sometimes also affect the reinsurer's financial arrangements in other ways, notably in regard to its own reinsurance. At one pole, the reinsurer is held prejudiced when denied the opportunity to benefit by the claims cooperation clause, particularly by association in defense of the claim.<sup>78</sup> At the other pole, a showing of actual loss to the reinsurer in consequence of late notice is required. This leads to a highly subjective examination of whether and how the reinsurer would have exercised its discretion and then to the even more speculative question of its effect on the outcome of the claim.<sup>79</sup> This is illustrated where a court of appeals overturned the trial court's findings of prejudice because they fell short of demonstrating a "substantial likelihood" that the reinsurer's association would have "defeated the underlying claim" or "settled the case for a smaller sum".<sup>80</sup> This is judgment by prophecy rather than facts.

As a counter-balance to this burden a doctrine has arisen that no prejudice need be shown if the reinsured's failure was in bad faith, measured by disparate standards of good faith.<sup>81</sup> While this may fall pleasantly on the ear as an endorsement of virtue, it has the vicious consequence of sending the court and parties off on another highly subjective inquest. If prejudice is to remain a factor, a reasonable middle ground would be to

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<sup>76</sup> See *Keehn v. Excess Ins. Co.*, 129 F.2d 503, 505 (7<sup>th</sup> Cir. 1942) (following Ill. law of direct insurance; "deprivation of such right [to associate] would constitute prejudice without any actual proof"); *Liberty Mutual Ins. Co. v. Gibbs*, 773 F.2d 15, 18 (1<sup>st</sup> Cir. 1985) (in contrast to Mass. statutory rule for protection of direct insureds); *Highlands Ins. Co. v. Employers Surplus Lines Ins. Co.*, 497 F. Supp. 169, 173 n. 3 (E.D. La. 1980) (both Mass. and Tex. law)

<sup>77</sup> See *Unigard Security Ins. Co. v. North River Ins. Co.*, 79 N.Y.2d 576, 594 N.E.2d 571, 584 N.Y.S.2d 290 (1992) on certificate from 4 F.3d 1049 (2<sup>nd</sup> Cir. 1993) (N.Y. law, prejudice required contrary to N.Y. rule in direct insurance); *Constitution Reinsurance Corp. v. Stonewall Ins. Co.*, 980 F. Supp. 124 (S.D.N.Y. 1997) (no prejudice required if condition explicit), *aff'd*, by summary order, 182 F.3d 899 (2<sup>nd</sup> Cir. 1999); *Security Mutual Casualty Co. v. Century Casualty Co.*, 531 F.2d 974 (10<sup>th</sup> Cir. 1976) (Colo. law; intention as condition precedent not found); *Insurance Co. of State of Pennsylvania v. Associated Int'l Ins. Co.*, 922 F.2d 516 (9<sup>th</sup> Cir. 1990) (following Calif. direct insurance prejudice rule with no controlling reinsurance authority).

<sup>78</sup> *Keehn*, *supra* note 76, at 505; *Liberty Mutual Ins. Co. v. Gibbs*, 773 F.2d 15, 18 (1<sup>st</sup> Cir. 1985)

<sup>79</sup> *Unigard supra* note 31, at 1069 (must show "tangible economic injury"); *Insurance Co. of State of Pennsylvania v. Associated Int'l Ins. Co.*, 922 F.2d 516 (9<sup>th</sup> Cir. 1990); *Fortress Re, Inc. v. Central Nat'l Ins. Co. of Omaha*, 766 F.2d 163, 167 (4<sup>th</sup> Cir. 1985) ("more favorable disposition of the claim").

<sup>80</sup> *Insurance Co. of State of Pennsylvania v. Associated Int'l Ins. Co.*, 922 F.2d 516, 524 (9<sup>th</sup> Cir. 1990) (referring to a Calif. direct insurance standard).

<sup>81</sup> See *Unigard, supra* note 31, at 1069 ("minimum standard for bad faith should be gross negligence or recklessness"); *Fortress Re, Inc. v. Central Nat'l Ins. Co. of Omaha*, 766 F.2d 163, 166 (4<sup>th</sup> Cir. 1985) ("measured by a subjective standard ... [not] ... an objective standard based upon the conduct of a reasonable person", quoting *Great American Ins. Co. v. C.G. Tate Construction Co.*, 74 N.C. App. 424, 328 S.E.2d 891, 894 (1985)).

recognize a rebuttable presumption of prejudice, leaving it to the reinsured actually in breach of contract to show by the reinsurer's general practice and other evidence that it would (probably) not have taken advantage of early notice in any material way. A rule very much like this was formulated in a California decision that was ordered "depublished" according to the curious practice of unringing the bell so that the courts of the state are not to hear it.<sup>82</sup>

### ***E. The Importance of Uniform Terms***

Not only is it important to observe the parties' freedom of contract by respecting the integrity of their own words, but it important also to promote the uniformity and reliability of the terms of reinsurance contracts as commercial documents. When the same words show up repeatedly with the same meanings in a given class of documents, a party should have to overcome a strong inference to prove a different meaning. The Second Circuit has spoken to this issue in holding clauses to mean the same in one reinsurance contract as they had held in another:

The efficiency of the reinsurance industry would not be enhanced by giving different meanings to identical standard contract provisions depending upon idiosyncratic factors in particular lawsuits. The meaning of such provisions is not a fact to be litigated anew each time a dispute goes to court.<sup>83</sup>

This is good commercial law on both sides of the water; as expressed in an English reinsurance case: "clauses such as the Claims Cooperation Clause are standard clauses, used in a range of reinsurances, where one might expect them to receive a uniform construction, whoever proposed them."<sup>84</sup>

## **V. Conclusion**

Reinsurance contracts should have the same meanings and results, as they cross state and national lines, which they commonly do. The principles of conflict of laws will determine their proper law, and there is more of fact and good sense than of law in their interpretation and construction. Uniformity can only be hoped for by adhering as closely as possible to the actual words of the contract and usages proven to prevail where it was made, avoiding local notions of public policy or judicial expedience, and giving effect where possible to uniformity of standard terms.

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<sup>82</sup> *Central Nat'l Ins. Co of Omaha v. Prudential Reinsurance Co.*, 241 Cal. Rptr. 773, 786-87 (Cal. App. 2<sup>nd</sup> Dist. 1987) depublished by order of Sup. Ct. May 5, 1988.

<sup>83</sup> *Unigard*, *supra* note 31, at 1071.

<sup>84</sup> *Gan Insurance Co. Ltd. v. Tai Ping Ins. Co. Ltd.*, [2001] Lloyd's Rep IR 667, 686 (C.A. Mance, L.J. 2001).