Twenty-five years ago, the United States Court of Appeals for the Second Circuit decided *Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co.*, setting forth the controversial rule that reinsurers may cap their losses under facultative certificates at the stated amount on the face of a certificate. Despite widespread industry criticism, this rule – often referred to as the “Bellefonte Rule” – has been followed by the majority of courts to consider the issue, citing Bellefonte as persuasive, if not dispositive authority. Contrast this with the commonly held perception that arbitration panels do not follow the Bellefonte Rule - choosing instead to consider extrinsic evidence, including industry custom and practice from the time of contract formation - and there exists the phenomenon of potentially large discrepancies in the value of same share facultative reinsurance issued by competing carriers solely because one carrier’s certificate included an arbitration clause.

While Bellefonte remains important to analysis of this issue under any certificate without an arbitration clause, recent decisions, including one by the Second Circuit, hint that courts may be increasingly agreeable to arguments that soften the inflexible application of the Bellefonte Rule. These cases signal a willingness to differentiate based upon examination of specific language of the certificate at issue, to find that a certificate is ambiguous, and to allow the parties to rely upon extrinsic evidence such as custom and practice to prove the meaning of the parties’ agreement. Perhaps these cases signal a bridging of the value gap referenced above.

Thus, the debate about the so-called Bellefonte Rule continues. This article reviews Bellefonte and the cases that have followed, and discusses recent decisions that address the law of reinsurers’ liability for expenses in excess of certificate limits. The article concludes by providing key takeaways from these cases.

**Bellefonte**

*Bellefonte*’s roots are in the Dalkon Shield litigation. In settling that litigation (which included a dispute about whether Aetna’s underlying policies were cost-inclusive), Aetna agreed to pay an amount substantially in excess of its position as to the amount of limits available under the underlying policies. Aetna then sought reimbursement from its reinsurers, including Bellefonte Insurance Company, for their respective shares of the settlement.

The reinsurance certificates at issue in *Bellefonte* provided, in relevant part:

[Provision 1] [Reinsurer] . . . [does hereby reinsure Aetna . . . (herein called the Company) in respect of the Company’s contract hereinafter described, in

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The District Court framed the issue as follows: “The parties do not dispute the underlying facts nor do plaintiffs dispute their obligation to pay Aetna for approximately $31 million in liability on the policies. The central question is whether plaintiffs are obligated to pay additional monies for defense costs and claim expenses over and above the reinsuror’s limits. The court noted, “[t]he ‘follow the fortunes’ clauses in the certificates are structured so that they coexist with, rather than supplant, the liability cap. To construe the certificates otherwise would effectively eliminate the limitation on the reinsurers’ liability to the stated amounts.” Therefore, “the limitation is to be a cap on all payments by the reinsurer,” and the ‘follow the fortunes’ doctrine does not allow Aetna to recover defense costs beyond the express cap stated in the certificates.

Aetna also argued that the phrase “in addition thereto” set forth in Provision 4 indicates that liability for defense costs is separate for liability from underlying losses. The Court disagreed:

We read the phrase ‘in addition thereto’ merely to differentiate the obligations for losses and for expenses. The phrase in no way exempts defense costs from the overall monetary limitation in the certificate. This monetary limitation is a cap on all payments under the certificate. In our view, the ‘in addition thereto’ provision merely outlines the different components of potential liability under the certificate. It does not indicate that either component is not within the overall limitation.

In reaching its decision, the Court distinguished Penn Re, Inc. v. Aetna Casualty & Surety Co., a decision from the Eastern District of North Carolina that found the reinsurers liable for defense costs in excess of the face amount of the reinsurance certificates. The court held that the certificate addressed the reinsurer’s “obligation for ‘costs’ incurred in settling claims brought by a third person alleging to have been injured by the insured’s product covered by the reinsurance certificate” and therefore it “requires that, in addition [to indemnity], plaintiffs pay their proportion of suit costs and expenses.”

The Bellefonte court noted “[w]e are aware of the unreported opinion to the contrary in Penn Re . . . . There, the court read virtually identical reinsurance certificates to bind two reinsurers for an amount which exceeded the face amount of the reinsurance certificates. We decline to follow the reasoning of that opinion. There, the court did not consider the ‘subject to’ clause of the first provision, which makes the ‘in addition thereto’ language ‘subject to’ the cap on liability in the second provision.”

Bellefonte’s Progeny

Notwithstanding industry amicus briefing, the Second Circuit reconfirmed, and expanded, the Bellefonte analysis in Unigard Security Insurance Co. v. North River Insurance Co. The Court began its analysis by summarizing its ruling in Bellefonte and noting that it “held that a virtually identical follow the fortunes clause did not ‘override the limitation on liability’ and that therefore the reinsurer was not liable for expenses in excess of the liability limit.”

The Court then examined the impact of the certificate’s follow the form clause, an issue that did not arise in Bellefonte (because there was uncertainty as to whether the reinsured policies provided supplemental expenses). The clause stated, in relevant part, that the liability of the reinsurers, “except as otherwise provided by this Certificate, shall be subject in all respects to all the terms and conditions of [X5–3672].” Notwithstanding this provision, the Court found that “Provision 1 of the Certificate, like the certificate in Bellefonte, provides that Unigard agreed to reinsurance North
Disputes over a reinsurer's liability for defense costs in excess of limits continue, and, twenty-five years later, the dispute over *Bellefonte* continues as well.

*Bellefonte: Now*  
Disputes over a reinsurer’s liability for defense costs in excess of limits continue, and, twenty-five years later, the dispute over *Bellefonte* continues as well. As described below, courts continue to find *Bellefonte* to be at least persuasive, and reach the conclusion that expenses in excess of certificate limits are not recoverable. Three courts recently, however, have distinguished and declined to follow *Bellefonte* on the basis of the specific language of the certificate at issue.

The Illinois Court of Appeals, in *Continental Casualty Co. v. MidStates Reinsurance Corp.*, found *Bellefonte* to be persuasive in holding that the certificate before it unambiguously limited both losses and expenses to the limits stated in the certificate. Applying the “four corners” approach, which presumes that the document speaks for itself and the intentions of the parties must be determined from the language used in drafting the agreement – the court held that “the certificates provided a clear policy limit, inclusive of expenses . . . .” Because the certificate was unambiguous, extrinsic evidence was not appropriate to be considered. The court also found that the contract terms in *Bellefonte* were similar to those before it and held that neither the follow the form nor the follow the fortunes clauses could be said to remove expenses from the overall liability cap in the reinsurance assumed.

The United States District Court for the Northern District of New York also addressed *Bellefonte* in *Utica Mutual Insurance Co. v. Clearwater Insurance Co.* There, Clearwater reinsured certain umbrella policies issued by Utica. The court articulated the “sole issue” as “whether
While Bellefonte remains important to analysis of this issue under any certificate without an arbitration clause, recent decisions, including one by the Second Circuit, hint that courts may be increasingly agreeable to arguments that soften the inflexible application of the Bellefonte Rule.

Utica can recover defense costs and/or other expense payments in excess of the sums stated in the Liability Clauses in the 1978 and 1979 Certificates -- $5 million and $2.5 million, respectively.” The certificates at issue provided, in relevant part:

[Preamble] [Clearwater], 2 in consideration of the payment of premiums, statements contained in the declarations, and subject to the terms and General Conditions of this certificate does hereby reinsure [Utica as follows]

General Conditions

Section D [Clearwater]’s Liability and Basis of Acceptance (the “Liability Clause”), which identifies the portion of Utica’s exposure that Clearwater agreed to reinsure.

Utica contended that Bellefonte and its progeny were distinguishable because the certificates used the phrase “[Clearwater]’s Liability and Basis of Acceptance” and describe Clearwater’s liability as a “share,” rather than using the word “limit,” as was the case in the certificates in Bellefonte, Unigard II, and Excess Insurance Co., Ltd. v. Factory Mutual Insurance.

The Court rejected Utica’s arguments. With respect to the absence of the word “limit,” the Court found that “Clearwater’s liability is described as a percentage share of the underlying policy limit. Thus, it logically follows that a percentage share of a policy limit is itself a limit on liability, despite the absence of the word ‘limit.’”

(emphasis in original). With respect to extrinsic evidence, the Court noted that “when a contract is unambiguous, as the Certificates are here, extrinsic evidence generally cannot be considered in its interpretation.” The Court continued by stating that “Bellefonte, Unigard II, and Excess Insurance did not consider evidence of custom or practice, thereby suggesting that, at least with respect to a limit-of-liability provision silent as to its coverage of expenses, such evidence should not be relied upon.”

The Court further reasoned that “Utica’s customs and practice evidence . . . purports to demonstrate that Bellefonte, Unigard II, and Excess Insurance were erroneously decided, because they established a presumption of cost-inclusiveness at odds with the reinsurance industry’s customs and practices,” but that “it is this court’s obligation to follow, not second-guess, controlling precedent, which Bellefonte, Unigard II, and Excess Insurance undoubtedly are.”

On the other hand, the Second Circuit addressed Bellefonte in Utica Mutual Insurance Co. v. Munich Reinsurance America, Inc. and, for the first time, distinguished its holding. There, Munich Re reinsured Utica for certain asbestos-related losses. Utica contended that Munich Re’s liability for expenses was not subject to the certificate’s liability limit. Following discovery, Munich Re moved for summary judgment, and Utica cross-moved to continue discovery asserting that Munich Re had failed to produce discovery related to choice of law and the interpretation of the certificate. The district court granted Munich Re’s motion and denied Utica’s motion. Utica appealed.

The certificate provided, in relevant part:

[Paragraph 1] The Reinsurer [Munich] agrees to indemnify the Company [Utica] against losses or damages which the Company is legally obligated to pay under the policy reinsured, resulting from occurrences taking place during the period this Certificate is in effect, subject to the reinsurance limits shown in the Declarations.

[Paragraph 2] The Company shall settle all claims under its policy in accordance with the terms and conditions thereof. If the reinsurance hereunder is pro rata, the Reinsurer shall be liable for its pro rata proportion of settlements made by the Company. If the reinsurance hereunder is excess, the Reinsurer shall be liable for its excess proportion of settlements made by the Company after deduction of any recoveries from pro rata reinsurance inuring to the benefit of the Reinsurer.

[Paragraph 3] The Reinsurer shall be liable for its proportion of allocated loss expenses incurred by the Company in the same ratio that the Reinsurer’s share of the settlement or judgment bears to the total amount of each settlement or judgment under the policy reinsured.

The “declarations” section of the certificate
provided, among other things, that the "limit of liability ceded to and accepted by" Munich Re is $5 million in excess of $5 million of Utica’s liability under the underlying policy.

On appeal, Utica argued that the certificate could be read to exclude expenses from the limit of liability. On this, the Court stated that “[t]he fact that Munich’s obligation to indemnify Utica against ‘losses or damages’ is expressly made ‘subject to’ the Certificate’s limit of liability suggests that the parties intended to exclude Munich’s liability for expenses —which is not expressly made ‘subject to’ the limit of liability -- from that limit.” However, the Court also stated that “Utica’s interpretation is not obviously correct” because Munich Re’s “liability for settlement payments is not expressly made ‘subject to’ the Certificate’s $5 million limit of liability, yet Utica does not argue that the limit of liability excludes settlements.”

Notably, the Second Circuit concluded that the certificate was "ambiguous as to whether its limit of liability includes expenses:"

Paragraph 1 could “operate as a general provision that limits all of Munich’s liability under the Certificate to $5 million, whereas the subsequent paragraphs describe Munich’s obligations more specifically, without removing them from the limit. Although this latter reading is certainly plausible, we do not think the absence of ‘subject to’ language in the paragraphs describing settlements and expenses is fatal to Utica’s position. If settlement payments are ‘losses or damages,’ then Munich’s liability for settlements is separately limited to $5 million by virtue of the first paragraph’s ‘subject to’ clause. The Certificate defines ‘loss expenses’ separately, so it is possible that settlements are ‘losses or damages’ while expenses are not.”

In reaching its decision, the Court distinguished Bellefonte. According to the Second Circuit, Bellefonte and Unigard “turned on a provision in the policies at issue that expressly made all of the reinsurers’ obligations ‘subject to’ the limit of liability; they did not hold that a limit of liability, without such ‘subject to’ language, is presumptively expense-inclusive.” The Court also distinguished Excess. There, the Court stated that it did not read it “as holding that any presumption of expense-inclusiveness can be rebutted only through express language or a separate limit for expenses.” Rather:

[The] Certificate’s statement that ‘losses or damages’ are ‘subject to’ the limit of liability reasonably implies that expenses are not. Although this negative implication is not strong enough—in the context of the Certificate as a whole —to demonstrate that expenses are unambiguously excluded from the limit of liability, we think it is sufficient to render the Certificate ambiguous, even in light of Excess.”

The Court remanded the matter to the district court with the direction that extrinsic evidence must be considered in construing the certificate, and that further development of the record may be necessary.

Citing the Second Circuit’s Utica v. Munich Re opinion as “instructive,” the Northern District of New York concluded in Utica Mutual Insurance Co. v. R&Q Reinsurance Co (“R&Q”), that the certificate before it was ambiguous. In R&Q, the Certificate provided that the reinsurer “in consideration of the payment of the premium and subject to the terms hereon and the general conditions set forth on the reverse side hereof, does hereby reinsure [Utica].” The court then went on to analyze, and reject, Bellefonte. Citing to the Second Circuit’s decision in Utica, the court found that Bellefonte did not establish a blanket rule that all limits of liability are presumptively expense-inclusive. The court continued that the “Subject to” language is key in creating such a presumption, but that presumption can be overcome. Moreover, even if a condition mirrors the language used in Bellefonte, “a court must still analyze the certificate as a whole in order to discern its meaning and conclude whether expenses are included, or in addition, to the limit of liability.”

In analyzing the certificates, the court found that there were variations from the certificate in Bellefonte. Here, the reinsurance accepted provision stated: “in consideration of the payment of the net premium and subject to the general conditions set forth on the reverse side hereof, the reinsurer does hereby reinsure [Name of Company’s Insured].” According to the court:

Instead of the terms being subject to the liability as in Bellefonte, the
liability is subject to the terms and conditions. This places greater emphasis on the conditions themselves, which may trump other aspects of the certificates. As a result, a condition that excludes expenses in calculating the total loss limit holds more weight than the amount of ‘Reinsurance Accepted’ when interpreting these certificates.

This was a difference that “cannot be ignored.” The court further stated that “Bellefonte highlighted the importance of the ‘subject to’ clause, and Utica demonstrated the ability of a court to reach a different interpretation. If anything, the terms of the certificates may have created a presumption of expense-exclusiveness.” The court opined that even if the certificates were analogous to Bellefonte, the Court would still have denied the motions on the grounds that a latent ambiguity exists.

Finally, the court held that extrinsic evidence was necessary to construe the terms of the contract in its entirety. “The application of industry custom and usage influences the meaning of the certificates, and highlights the existence of genuine issues of material fact which are to be determined by the finder of fact.”

**Bellefonte: Where Are We Now?**

The Bellefonte debate continues with courts reaching different conclusions on the issue. Those courts that follow Bellefonte have held, to some degree notwithstanding variations in the certificate language, that the certificates at issue were unambiguous. As such, extrinsic evidence has not been considered, or permitted to be considered, in interpreting the certificates.

Other courts, however, have shown a willingness to break from Bellefonte. Those courts that have distinguished Bellefonte have done so largely on the basis of the certificate language, finding them to be ambiguous, missing or inverting the critical “subject to” provision, and/or holding that the “subject to” language is not necessarily dispositive. Both Utica v. Munich Re and Utica v. R&Q directed the consideration of extrinsic evidence to ascertain the parties’ intent. OneBeacon also identified the significance of custom and practice evidence to this analysis.

Therefore, when faced with Bellefonte-related issues, the following bear consideration in determining the value of facultative reinsurance:

- The existence of an arbitration clause;
- The language of the certificate at issue: To the extent that Bellefonte has not been followed, it has been because the language was distinguishable from the critical “subject to” language contained in the Bellefonte certificate;
- The applicable law: Although it has not yet set the basis for a reported Bellefonte decision, some jurisdictions allow extrinsic evidence even without a showing of ambiguity; and
- The types of extrinsic evidence considered: Where a certificate is determined to be ambiguous, courts look to extrinsic evidence, including evidence of the parties’ intent at underwriting and evidence of industry custom and practice.

Recent decisions may signal a willingness of courts to soften, or even distinguish, the Bellefonte Rule. Of note to this analysis will be the resolution of the Clearwater case which may present the Second Circuit with another opportunity to address this issue. Regardless of that result, however, further parsing of certificate language is expected as cedents continue to assail the Bellefonte Rule in the courts.

**ENDNOTES**

1. 903 F.2d 910 (2d Cir. 1990).
3. Interestingly, both parties argued that the facultative certificates were unambiguous and therefore neither attempted to introduce custom and practice evidence at this stage of the proceedings.
5. 4 F.3d 1049 (2d Cir. July 31, 1993).
7. The certificate provided:
8. E. All loss settlements made by the Company, provided they are within the terms and conditions of this Certificate of Reinsurance, shall be binding on the Reinsurer. Upon receipt of a definitive statement of loss, the Reinsurer shall promptly pay its proportion of such loss as set forth in the Declarations. In addition thereto, the Reinsurer shall pay its proportion of expenses (other than office expenses and payments to any salaried employee) incurred by the Company in the investigation and its proportion of court costs and interest on any judgment or award, in the ratio that the Reinsurer’s loss payment bears to the Company’s gross loss payment . . . . (emphasis in original).
11. 3 N.Y.3d 577 (N.Y. Ct. App. 2004) (following Bellefonte and Unigard and holding “that “[o]nce the reinsurers have paid the maximum amount stated in the policy, they have no further obligation to pay Factory Mutual any costs related to loss adjustment expenses” and that reinsurers “cannot be required to pay loss adjustment expenses in excess of the stated limit in the reinsurance policy”).
12. On April 20, 2015, Utica filed a Motion for Reconsideration arguing that, in light of the Second Circuit’s decision in Utica Mutual Insurance Co. v. Munich Reinsurance America, Inc., No. 13–4170-CV, 2014 WL 6804553 (2d Cir. Dec. 4, 2014), the certificates were ambiguous. The United States District Court for the Southern District of New York recently denied a similar motion for reconsideration filed by the cedent in Global Reinsurance Corp. of America v. Century Indemnity Co., 13 Civ. 06577 (LGS) (S.D.N.Y. Apr. 15, 2015). The court held, on Global’s motion for summary judgment, that Bellefonte and Unigard were controlling and that the dollar amount indicated on the certificates was the maximum that Global could be obligated to pay for loss and expenses combined. 2014 WL 4054260 at *6–7. On the motion for reconsideration, the court rejected the argument that Utica constituted an intervening change in controlling law and held that, in any event, the language of the certificates was such that Utica did not counsel a different result.
herein, shall be subject in all respects to all the terms and conditions of the Company’s policy . . . “ General Condition 3 provided: “All claims involving this reinsurance, when settled by the Company, shall be binding on the Reinsurer, who shall be bound to pay its proportionate share of such settlements, and in addition thereto, in the ratio that the Reinsurer’s loss payment bears to the Company’s gross loss payment, its proportionate share of expenses . . . incurred by the Company in the investigation and settlement of claims or suits . . . .”

In its motion for summary judgment, OneBeacon argued that the limit stated in “Reinsurance Accepted” places a total cap on OneBeacon’s liability, which includes expense payments.

The court first noted that the issue of whether the calculation of expenses are included in, or separate and apart from, the stated limit is a case of first impression in Pennsylvania. The court described relevant cases published by federal courts and neighboring state courts as “persuasive authority,” but noted that it must conduct its own analysis under Pennsylvania law without the guidance of binding authority.

OneBeacon argued that the court should adopt the reasoning of *Bellefonte Reinsurance Co. v. Aetna Casualty & Surety Co.*, 903 F.2d 910 (2d Cir. 1990) and its progeny, which limit expense payments to the certificate’s overall liability cap. Judge Glazer discussed the *Bellefonte* case, but noted that the Second Circuit in *Bellefonte* focused on a clause in the certificate that made the expense provision “subject to” the amount of liability to reach its conclusion. Judge Glazer also relied upon the Second Circuit’s recent decision in *Utica Mutual Insurance Co. v. Munich Reinsurance Am., Inc.*, No. 13-4170-CV, 2014 WL 6804553, at *4 (2d Cir. Dec. 4, 2014), observing that Utica clarified the holding in *Bellefonte* that there was no blanket rule that all limits of liability are presumptively expense-inclusive. Citing *Utica*, Judge Glazer concluded that “[e]ven if a condition mirrors the language used in *Bellefonte*, a court must still analyze the certificate as a whole in order to discern its meaning and conclude whether expenses are included, or in addition, to the limit of liability.”

Judge Glazer compared the language in the facultative certificates at issue in this case with the language in *Bellefonte* and held that “while similar to *Bellefonte*, [the language] contains slight variations which leads to a different conclusion.” Specifically, the language on the front side of the certificates states that premium is “subject to the general conditions set forth on the reverse side hereof…” General Condition 1 states that “[t]he liability ... shall be subject ... to all the terms and conditions of the Company’s policy.” Judge Glazer distinguished the language in the certificates at issue with those in *Bellefonte* because the certificates at issue made the liability subject to the terms and conditions rather than the terms being subject to the liability, as in *Bellefonte*. Judge Glazer reasoned that this language places greater emphasis on the conditions themselves. “As a result, a condition that excludes expenses in calculating the total loss limit holds more weight than the amount of ‘Reinsurance Accepted’ when interpreting these certificates.” Denying One-Beacon’s motion for summary judgment, Judge Glazer concluded that, if anything, the terms of the certificates may have created a presumption of “expense-exclusiveness.”

The court also determined that the facultative certificates contained a latent ambiguity and that extrinsic evidence was required to discern the intent of the parties: “The application of industry custom and usage influences the meaning of the certificates, and highlights the existence of genuine issues of material fact which are to be determined by the finder of fact.”

continued from *Bellefonte*, page 10

15. Condition 4 of the certificate also provided that “should the [reinsured’s] policy limit include expenses, the Reinsurer’s maximum limit of liability shall be as stated in Item 4 of the Declaration [i.e., $1 million].” R&Q did not seek summary judgment on whether this language applied to limit its liability to $1 million, but the court considered it further to its analysis of whether the certificate was ambiguous. Relying on the principle that “when certain persons or categories are specific in a contract, an intention to exclude all others may be inferred,” the court held that “the fact that the Certificate states one particular instance in which R&Q’s liability limit includes expenses implies that its liability limit does not include expenses in other instances.” The court also held that to read the liability limit as an absolute cap on loss and expense would render this provision superfluous, which is a disfavored result.


17. In *OneBeacon*, the broker industry, as *amici*, urged the court to “consider the longstanding reinsurance industry practice and custom treating the loss limits in facultative certificates as expense-exclusive, in accordance with industry expectation that the reinsurance coverage with be concurrent with the underlying insurance policy.”

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