

Second Circuit Rules That Reinsurer Is Bound By Cedent's Underlying Allocation (Insurance Law Alert)

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Affirming a New York district court decision, the Second Circuit ruled that a reinsurer was obligated to indemnify its cedent's underlying settlement payments, rejecting the reinsurer's assertion that the settlement was outside the scope of coverage under the cedent's excess policy and the reinsurance policy. *Fireman's Fund Ins. Co. v. OneBeacon Ins. Co.*, No. 20-4282 (2d Cir. Sept. 15, 2022).

Fireman's Fund issued excess policies to ASARCO that conditioned payment on exhaustion of underlying insurance. One excess policy was reinsured by OneBeacon, as successor-in-interest to the original reinsurer. OneBeacon denied coverage for Fireman's Fund's underlying settlement payments, arguing that it violated the exhaustion requirement of its excess policies because it allocated a portion of the payment to a policy without first exhausting the full policy limits of underlying excess policies.

As discussed in our [October 2020 Alert](#), a New York district court rejected OneBeacon's assertion, ruling that it was bound by Fireman's Fund's allocation decision pursuant to a follow the settlements clause. More specifically, the district court explained that the exhaustion requirement in Fireman's Fund's policy was ambiguous, and therefore under New York precedent, could be met through a below-limits settlement of the underlying policy so long as the total covered losses exceeded the policy's attachment point. The district court also rejected OneBeacon's contention that the reinsurance policy itself required payment of policy limits in full by underlying primary and excess policies before reinsurance coverage would attach.

The Second Circuit affirmed, ruling that the exhaustion provisions at issue did not unambiguously require underlying insurers to pay full underlying limits and instead, permitted exhaustion by a below-limits settlement. The court explained that a Payment of Loss provision did not define "exhaustion" or specifically require actual payment. Additionally, the court held that a Limit of Liability provision, which did require exhaustion of limits "solely by reason of losses paid thereunder," was irrelevant to this case because that provision applies only when underlying aggregate limits of liability have been reduced or exhausted by previous per-occurrence claims, requiring that excess insurer to provide coverage at a lower attachment point, which was not the case here.

OneBeacon also argued that Fireman's Fund was judicially estopped from arguing that the exhaustion provision was ambiguous because it took a "clearly inconsistent" position in other litigation. The court rejected this assertion, concluding that the position taken by Fireman's Fund in

other cases was not inconsistent with its current interpretation of the exhaustion requirement.

Finally, the Second Circuit ruled that the OneBeacon’s reinsurance policy did not require full payment of the underlying limits of liability by the underlying insurers before reinsurance coverage attached. The relevant provision in the policy provided that there was no reinsurance coverage “for any loss under \$78 million.” The court explained that, “reminiscent of the exhaustion issue,” the reinsurance policy’s attachment point is not contingent upon payment by underlying insurers; rather, the reinsurance policy applies once the policyholder’s covered losses exceed \$78 million.

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