Collecting Old Premium and Loss Balances

and the Account Stated Principle

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I. Introduction

Today there are organizations that mine old premium and loss data seeking to collect additional funds using access to records clauses or audit rights. It may be difficult for the recipient of such a request to comply given changes in ownership and data processing systems, gaps in record retention, corruption of data and the death or retirement of principal players. Some would argue that there should be a limit, temporal or otherwise, on the ability to question the accuracy of old accounting statement in order to better one's financial condition.

In fact, there are several principles that provide such a limit, one being the account stated principle. The purpose of this article is to explore selected case law in order to articulate the principle and to provide examples of it in operation.

II. Articulation of the Account Stated Principle

Perhaps the best articulation of the account stated principle is contained in *American Home Assurance Co. v. Instituto Nacional de Reaseguros*, 1991 U.S. Dist. LEXIS 501 (S.D. NY). Interpreting New York law, the court stated that failure to object to a statement of account within a reasonable time creates a rebuttable presumption of agreement by the recipient of the accounting statement ("Recipient") with its accuracy. This presumption may be rebutted by proof of fraud or mistake. However, the fraud or mistake must take place within the accounting method used by the issuer of the accounting statement ("Issuer") *i.e.* through the account stated principle, a Recipient claiming fraud or mistake loses the ability to challenge the Issuer's accounting methods. Also, even if a Recipient is able to demonstrate mistake within the Issuer's accounting methods, this mistake is not a defense if the delay in asserting the mistake put the Issuer in a worse position than if the protest had been timely.[1]

III. **Case Law Applying the Account Stated Principle**

The fact situation in *American Home Assurance,* cited immediately above, was as follows. The cedent sent quarterly accounts to the reinsurer from the second quarter of 1984 to the second quarter of 1987 showing a balance due to the cedent. The reinsurer admitted receiving the statements and did not dispute any of them until the cedent brought suit in 1988. The reinsurer sought documentation on the balances in machine-readable form which the cedent averred was not available. The reinsurer did not want to spend the time and money necessary to review all the paper involved. The court accepted the cedent's account stated argument:

> The case then, comes down to this. [The reinsurer's] failure to protest or inquire about the quarterly statements converts those documents into an account stated. The burden thereupon shifts to [the reinsurer] to prove the sort of mistakes cognizable in law to support an adjustment of the stated account. If the circumstances render it difficult or expensive for [the reinsurer] to sustain that burden, that is the price [the reinsurer] must pay for failure to object or inquire with a reasonable time. Furthermore, if its delay has prejudiced [the cedent] in its ability to recapture pertinent information, [the reinsurer] must accept the consequences.[2]

Kramer, Nessen, Kamin & Frankel v. Aronoff. 638 F. Supp., 714 (S.D.N.Y. 1986) was a suit by a law firm against a former client for legal fees. The firm represented the client between December 1, 1976 and August 30, 1979. The client paid two of the periodic bills in 1977 and one in 1979. Thereafter, the client was convicted of mail fraud. In March 1982, the law firm demanded payment of its final bill. At that point, the client disputed the propriety of the law firm's bill. Acknowledging a rule of law very similar to that stated in *American Home Assurance, supra,* the court ruled in favor of the law firm on the basis of account stated:

> An agreement to pay indebtedness may also be implied if the debtor makes partial payment. The partial payment is considered acknowledgement of the validity of the account. . . New York courts have consistently held such partial payments to be acknowledgement of the correctness of the account. . .
> . . . Here where almost three years passed before [the client] questioned the billing, such a period of silence - - in which there was ample opportunity to object to the

billing - - amounts to an implied acquiescence to the stated account.[3]

Seaton Ins. Co. v. Yosemite Ins. Co., 748 F. Supp. 2d 139 (D. R.I. 2010) involved facultative certificates on two umbrella policies, one effective from October 1, 1973 to October 31, 1975 and the other effective April 1, 1973 to January 1, 1976. The reinsurer declined to pay losses citing violation of retention agreements and the cedent sued for breach of contract. The reinsurer counterclaimed for return of premium and the cedent countered with the account stated principle. The evidence indicated that the reinsurer received and paid bills for losses starting in 1986 and continuing into the 1990's. The reinsurer also received reconciliations and raised detailed questions that were answered by the cedent. The reinsurer conducted multiple audits one of the policy files. Interpreting California law, the court denied the reinsurer's counterclaim based on the account stated principle:

> To prove that a debtor's payments are an account stated, the recipient must show the following: 'that at the time of the statement an indebtedness from one party to the other existed, that a balance was then struck and agreed to be the correct sum owing from the debtor to the creditor, and that the debtor expressly or impliedly promised to pay to the creditor the amount thus determined to be owning.'[4]

With respect to the timing of the reinsurer's claims, the *Seaton* court stated:

> It could not be clearer that [the reinsurer] failed to object within a "reasonable time' to the payments, the bulk of which occurred in the 1980's and 1990's. By its own account, [the reinsurer] did not identify any problem with it liability under the Certificates until 2007 at the earliest. [The reinsurer] did, however, timely object to amounts pending and owed in the future, so the account stated doctrine is no help to [the cedent] for sums yet to be paid on either Policy.[5]

In Re Rockefeller Center Properties and RCP Assoc., 2000 Bankr. LEXIS 1925 was a factually complex case involving the former owners of the Rockefeller Center complex (in bankruptcy) and a tenant, NBC, that filed suit in 1995 claiming it was overcharged for rent escalations for the years 1987 to 1993. At the time of the suit, NBC had been in possession of the rent escalation statements for between one and five years. During this period of time, NBC had performed several audits and settlements of certain issues were negotiated with the landlord. Interpreting New York law, the court stated that:

> Under the [account stated] doctrine, a party who receives an account is bound to examine it, and if that party admits that the account is correct, it becomes an account stated and is binding on both parties. Express assent to the account is not necessary. Such assent may be inferred by silence when an account rendered remains unquestioned a reasonable time after receipt.[6]

While fraud or mistake can be used to rebut the presumption created by account stated:

> [A] limitation on the ability to rebut or impeach an account stated is that once a failure to object gives rise to an account stated, the objecting party may no longer contest the account method which was used throughout the relationship without protest. The objecting party in such circumstances is limited to proving factual mistakes with the context of an accounting method it is no longer entitled to challenge.[7]

The *Rockefeller Center* court found in favor of the debtor on the basis of the account stated principle ruling that the parties had negotiated and resolved a number of the disputes between them, fraud was not alleged and that any remaining mistakes in accounting where not supported by adequate proof.

Another factually complicated case is *Aioi Nissay Dowa Ins. Co. Ltd. v. ProSight Specialty Mgt. Co. Inc.*, 2013 U.S. Dist. LEXIS 875050 (S.D.N.Y). Aviation risk was ceded to a three-member reinsurance pool by the cedent pursuant to treaties with reinstatement premiums. The pool also insured the cedent's reinstatement premiums. After 9/11, two members of the pool became insolvent and negotiated commutations with the cedent which involved setoffs going in both directions but with solvency discounts from the amounts due from the insolvent reinsurers.

The reinstatement recoverables due from the pool were based on losses paid. The cedent represented to the remaining solvent pool member that 100% of the losses were paid when, in fact, they were discounted in the settlement with the other two pool members. This resulted in a mistake on the part of the remaining pool member on amounts due and owing that obviated the application of the account stated principle.

IV. **Commentary**

Conflicts over old premium and loss balances can be both troublesome and expensive to resolve when data processing systems have been superseded, information has been lost or corrupted and principals have retired or died. From a policy standpoint, it certainly can be argued that at some point, questions on accounting balances must cease. The account stated principle is one way of enforcing this argument.

ENDNOTES

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[1] 1991 U.S. Dist. LEXIS *6-8.

[2] *Id.* at *9-10.

[3] 638 F. Supp. 714 at 720 (internal citations omitted).

[4] 748 F. Supp. 2d 139 at 158, quoting *H. Rullell Taylor's Fire Prevention Serv., v. Coca Cola Bottling Corp.,* 160 Cal Rptr. 411 (Cal. Ct. App. 1979).

[5] *Id.* at 159, (internal citations omitted).

[6] 2000 Bankr. LEXIS *35-36.

[7] *Id.* at *58 fn. 21.