FIDUCIARY DUTY IN THE

REINSURANCE RELATIONSHIP

By

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I. Introduction

The relationship between a cedent and reinsurer is characterized in various ways. It is often characterized as one of utmost good faith.[1] Somewhat less often, the cedent's relationship to the reinsurer is characterized as a fiduciary one. The purpose of this article is to explore the case law concerning the existence of fiduciary obligations running from the cedent to the reinsurer.

II. Case Law Supporting a Fiduciary Relationship

Mutuelle Generale Francaise Vie v. Life Assurance Co. of PA., 688 F.Supp. 386 (N.D. Ill. 1988) is a curious split decision on fiduciary duty. The issue was whether the cedent (LACOP) improperly administered and ceded business to the reinsurer (MGF) through an automatic treaty. The court initially dismissed the precedential value of an earlier Illinois trial court decision finding that a cedent has a fiduciary obligation to the reinsurer.[2] The court then broke out LACOP's duties with respect to the business ceded and how that business was administered. Given that the treaty was automatic, the court found, LACOP's responsibilities in ceding business was ministerial and, therefore, not fiduciary in nature. With respect to administration, however, the court found a fiduciary duty:

> In that regard the parties' relationship is that of fiduciary and principal, Effectively, LACOP was MGF's agent in providing information on the ceded policies, forwarding the premiums and investigating and paying claims . . . . Under the Treaty MGF was entitled to place its "highest faith" in LACOP . . . . In that sense and to that extent, MGF placed its confidence in LACOP's fair administration of its Treaty responsibilities, and LACOP was in a dominant and influential position in carrying out its reporting and administration obligations.[3]

Columbian National Fire Ins. Co. v. Pittsburgh Fire Ins. Co.**,** 210 N.W. 258 (Mich. 1926) raised the issue of whether or not the cedent held its proper retention under a surplus share treaty. With virtually no analysis of the fiduciary issue, the court concluded:

> The parties were not dealing at arms' length. Under the contract plaintiff occupied a fiduciary position demanding fairness, and open disclosure of all reinsurance reducing its agreed retention of risks, and if its failure to disclose was intentional it constituted fraud in the eye of the law.[4]

Some support for a fiduciary obligation can be found in Continental Cas. Co. v. Stronghold Ins. Co. LTD., 77 F.3d 16 where in the court stated" "Although it has been said that the relationship between a reinsured and its reinsurer is not technically a fiduciary one . . . centuries of history have treated both as allies rather than adversaries."[5]

III. Case Law Which Denies a Fiduciary Relationship

Lack of prompt notice of a claim of a claim was the issue in Christiania General Ins. Corp. of N.Y. v. Great American Ins. Co., 979 F.2d 268 (2nd Cir. 1992). The court rejected the reinsurer's argument that lack of prompt notice was a breach of fiduciary duty:

> Christiania's characterization of the relationship between a reinsured and reinsurer as being inevitably fiduciary in nature is one we are unable to adopt. To the contrary, because these contracts are usually negotiated at arms length by experienced insurance companies . . . there is no reason to label the relationship as "fiduciary."[6]

A counterclaim by the cedent alleging a breach of fiduciary duty by the reinsurer in not paying claims provides the backdrop to the recent case Employers Reinsurance Corp. v. Massachusetts Mutual Life Ins. Co., 2007 U.S. Dist. Lexis 24161 (W.D.Mo.). The court granted the reinsurer's motion to dismiss the counterclaim:

> Under Connecticut law, there is a fiduciary relationship when "a fiduciary or confidential relationship is characterized by a unique degree of trust and confidence between the parties, one of whom has superior knowledge, skill or expertise and is under a duty to represent the interests of the other . . . The superior position of the fiduciary or dominant party affords him great opportunity for abuse of the confidence reposed in him." . . . [D]efendant fails to allege facts that there was a unique degree of trust and confidence between the parties or that plaintiff had superior knowledge, skill, or expertise. Rather, both plaintiff and defendant are two sophisticated insurance companies who most likely encompass vast knowledge and expertise about insurance and reinsurance issues. In this scenario, it is unlikely that one of the parties was able to dominate the other in the negotiation and performance of their agreement.[7]

United States of America v. John Brennan, 183 F.3d 139 (2nd Cir. 1999) was the appeal of a criminal conviction for mail fraud against John Brennan, CEO of US Aviation Underwriters ("USAU") which managed an aviation pool. It was alleged that Brennan had a conflict of interest which influenced his settlement and allocation of losses among the pool, other co-insurers and a security company due to a plane crash. One of the arguments in the trial court was that Brennan had a fiduciary responsibility to a number of the aggrieved parties. Although the conviction was overturned on another basis, the court had pointed comments to make about this argument in *dicta*:

> [W]e have emphasized that "a fiduciary relationship involves discretionary authority and dependency" and that "at the heart of the fiduciary relationship lies reliance, *and defacto control and dominance*. The relation exists when confidence is reposed on one side and there is resulting superiority and influence on the other. . . ." We think the elements of domination and control are of particular importance in a case like this one, where all parties to the various contractual relationships were concededly sophisticated companies with experience in the industry, and where the alleged victims had a variety of practical and contractual rights to participate in or challenge defendants' decisions.[8]

Following the Mutuelle Generale decision, *supra*, several decisions were handed down from the same court finding that the cedents in those cases did not have fiduciary obligations to the reinsurer, largely for the reasons cited in the case law above. *See* International Surplus Lines Ins. Co. v. Fireman's Fund Ins. Co., 1989 U.S. Dist. Lexis 15626 (N.D. Ill.); International Ins. Co. v. Certain Underwriters at Lloyd's, U.S. Dist. Lexis 12948 (N.D. Ill.).

Following these cases, Judge Shadur, the author of Mutuelle Generale, handed down a series of decisions[9] related to a single dispute in which a reinsurer sought rescission for alleged breach of the duty of utmost good faith by the cedent.[10] Repeatedly characterizing the utmost good faith standard as a fiduciary one, Judge Shadur dismissed the claim for rescission due to lack of fiduciary duty owed from the cedent to the reinsurer.

IV. Conclusion

While case law is split, it is evident that the greater weight of decisions do not support fiduciary obligations running from the cedent to the reinsurer. Given that the parties to the reinsurance transactions are large, or relatively large, financial institutions which possess, or have access to, significant reinsurance expertise, it is difficult to show the dominance and reliance traditionally inherent in a fiduciary relationship.

Endnotes

[1] For an articulation of this standard, *see* § V, Robert M. Hall, *Is the Obligation of Utmost Good Faith Dead in Illinois*, XVI Mealey's Reins. Rpt. No. 3 at 21 (2005). It is also available at the author's website: robertmhall.com.

[2] 688 F.Supp. 386 at 397. The Illinois trial court decision in question is American Re-Insurance Co. v. MGIC Investment Corp., No. 77 CH 1457, slip op. (Cir. Ct. Cook County, Ch. Div. Oct. 20, 1987).

[3] 688 F.Supp. 386 at 396.

[4] 258 N.W. 258 at 259.

[5] 77 F.3d 16 at 21-2 (Internal citations omitted).

[6] 979 F.2d 268 at 280-1.

[7] 2007 U.S. Dist Lexis 24161 *10-11 (internal citations omitted).

[8] 183 F.3d 139 at 150-1 (internal citations omitted emphasis in the original).

[9] PXRe Reinsurance Com. V. Lumberman's Mutual Cas. Co., 2004 U.S. Dist. Lexis 9343 (N.D. Ill); PXRe Reinsurance Co. v. Lumberman's Mutual Cas. Co. 300 F.Supp.2nd 981 (N.D. Ill); PXRe Reinsurance Co. v. Lumberman's Mutual Cas. Co., 21552 (N.D. Ill).

[10] For a more complete evaluation of these cases, and those that preceded them, *see* Robert M. Hall, *Is the Obligation of Utmost Good Faith Dead in Illinois?* Mealey's Reins. Rpt. No. 3 at 21 (2005) also available on the author's website: robertmhall.com.