LOSS NOTICE AND SUNSET CLAUSES IN REINSURANCE TREATIES

By

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I. Introduction

Sunset clauses were invented during the hard market of the mid-1980's as a means of reducing the reinsurer's long tail exposure. In essence, they terminate the reinsurer's liability for claims which are not reported by a specific date. It has always been an open question as to what type of report is necessary to preserve the cedent's rights to claim reinsurance recoverables *i.e.* a brief bordereau approach or the full detail required by the loss notice provision in the treaty. Thirty years hence, there is some case law which suggests an answer to this question.

II. Contract Language

The case law on point is a series of decisions related to a retrocessional contract between Munich Reinsurance America, Inc. ("Munich") as cedent and American National Insurance Company ("American National") as the assuming carrier. The sunset clause, which was contained within a commutation provision, provided:

> Seven years after the expiry of this Agreement, the Company shall advise the Reinsurer of all claims for said annual period, not finally settled which are likely to result in a claim under this Agreement. No liability shall attach hereunder for any claim or claims not reported to the Reinsurer within this seven year period.[1]

The loss notice provision provided:

> A. The Company agrees to advise the Reinsurer promptly of all claims coming under this Agreement on being advised by [the policy issuing company], and to furnish the Reinsurer with such particulars and estimates regarding same as are in the possession of the Company. An omission on the part of the Company to advise the Reinsurer of any loss shall not be held to prejudice the Company's rights hereunder.
> B. In addition, the following categories of claims shall be reported to the Reinsurer immediately, regardless of any questions of liability of the Company or coverage under this Agreement:

1. Any accident reserved at 50% of the reinsured attachment point;
2. Any accident involving brain injury;
3. Any accident resulting in burns over 25% or more of the body; or
4. Any spinal cord injury.[2]

III. Sunset Clause Claim Reporting

The sunset clause reporting by Munich consisted of a bordereau-like, 24 page spreadsheet that listed all workers compensation claims reported to Munich by the policy issuing insurer during the course of the program including claims during years that American National did not participate in the cover. The spreadsheet, as of August 8, 2008, provided 21 categories of information for each claim including named insured, date of loss and reported and paid loss amounts and ALAE. There was no legend on the spreadsheet to identify codes used and Munich's fact witnesses could not identify all of the codes.[3]

IV. The Decision

A. Round One

In general, this was a suit by Munich against American National for reinsurance recoverables. American National asserted a defense of late notice and counterclaimed for rescission based on violation of the obligation of utmost good faith, among other things. Round one, *Munich Reins. Amer., Inc. v. American National Ins. Co.,* 2012 U.S. Lexis 140334 (D.N.J.) consisted of rulings on motions for partial summary judgment.

On the issue of loss notice, the court ruled that providing notice in accordance with the loss notice clause in § II, *supra*, is not a condition precedent to the obligation to pay claims.[4] However, the court did not address the sunset clause issue.

B. Round Two

Munich Reins. Amer., Inc. v. American National Ins. Co., 2013 U.S. Dist. Lexis 4435 (D.N.J.) was a reconsideration of the earlier decision. The court agreed to reconsider the loss notice issue on the basis that the sunset clause issue had not been sufficiently highlighted in the briefs. The court found that the sunset clause was a condition precedent to the obligation to pay claims commenting: "On its face, the sunset provision here is straightforward: it prevents Munich from reporting claims in perpetuam, by excluding from coverage those claims not noticed with seven years following the expiration of each retrocessional agreement."[5] The court ruled:

> In sum, because [the sunset clause] operates as a condition precedent, it makes clear that [American National] is obligated to indemnify only those claims that were noticed within seven years following the expiration of the relevant retrocessional agreement. . . . With respect to the 2001 agreement, Munich was obligated to notify [American

> National] of all claims by the sunset deadline of December 21, 2008. Munich contends that it provided notice of those claims via the August 8, 2008 spreadsheet.[6]

The court found that there were issues of material fact as to the sufficiency of the notice provided by the spreadsheet thus setting the stage for round three.

C. Round Three

The court cited testimony from a claims person at American National that when she received the spreadsheet, she informed her counterpart at Munich that the spreadsheet was not sufficient notice and that an individual notice was necessary on each claim in accordance with the loss notice provision quoted above in § II. *Munich Reins. Amer., Inc. v. American National Ins. Co.*, 2014 U.S. Dist. Lexis 25078 *94-5. Apparently, this was not forthcoming.

The court considered expert testimony that: (a) loss bordereaux are a common form of treaty loss reports but that (b) the sunset clause was part of a commutation provision and that more robust information is necessary to determine which claims might penetrate the reinsured layer and to support the calculations necessary for a commutation. The court held that the spreadsheet did not provide adequate notice characterizing the issue as follows:

> I find that the August Spreadsheet did not include sufficient information that would have allowed [the MGA for American National] to make a determination on the likelihood that a claim arising under the [relevant treaty] would breach [American National's] retrocessional layer. [7]

V. Comments

This series of cases suggests an answer to the question of whether or not a bordereau claim report will suffice for sunset clause purposes. However, the decision is notable in that it did not subject the claim reporting for purposes of the sunset clause to the requirements of the general notice of loss requirements described in § II, *supra.* Perhaps subsequent case law will determine what level and/or type of claim reporting will be sufficient for sunset clause purposes.

ENDNOTES

1 Munich Reins. Amer., Inc. v. American National Ins. Co., 2013 U.S. Dist. Lexis 44345 *46 (D.N.J).

2 *Id.* at *4.

3 Munich Reins. Amer., Inc. v. American National Ins. Co., 2014 U.S. Dist. Lexis 25078 *90-2 (D.N.J).

4 2012 U.S. Dist. Lexis 140334 *41.

5 2013 U.S. Dist. Lexis 44345 *51.

6 *Id.* at 59-60.

7 2014 U.S. Dist. Lexis 25078 *99 – 101.