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**MEMORANDUM**

**TO:** National Conference of Insurance Legislators Foundation Board

**FROM:** Julius A. Rousseau, III  
Herrick, Feinstein LLP

**DATE:** November 14, 2005

**RE:** Enforceability of U.S. Judgments Abroad

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**SUMMARY OF ANALYSIS**

The Insurance Legislators Foundation Board of NCOIL retained us to provide an independent analysis of the enforceability of U.S. court judgments and U.S. arbitration awards in foreign countries. We have examined this subject in a very narrow context -- a U.S. domiciled insurer has obtained a monetary judgment or arbitral award against a non-U.S. domiciled, unauthorized reinsurer pursuant to the terms of a reinsurance agreement containing the standard clauses required for the ceding insurer to take statutory credit for the reinsurance. The U.S. court or arbitration panel thus had jurisdiction, by agreement, and service of process in the U.S. was effected by the terms of the reinsurance agreement.

Because we cannot offer an opinion as to the law of any other country, we have relied upon opinions of law firms in other countries to draw some of our conclusions about enforceability in those countries. By comparing the legal process in those countries with the concept of "Full Faith and Credit" between the states of the United States and with the treatment

that the states give to judgments from other countries, we have reached the following conclusions:

1. To enforce an arbitral award, the cedent could invoke the New York Convention, an international treaty for the enforcement of arbitral awards to which the U.S. and most relevant countries are signatories. Under the Convention, **an arbitral award will likely be enforced absent extreme circumstances such as fraud, failure to comply with the terms of the contract concerning the arbitration, or matters of public policy.**
2. A U.S. cedent with a court judgment, following trial or arbitration, could seek the benefit of comity from a foreign court. Just as U.S. courts apply principles of comity among the states and to foreign court awards, foreign courts apply comity to U.S. judgments. As with their review of an arbitral award under the New York Convention, **foreign courts are likely to enforce a U.S. court judgment absent extreme circumstances such as the reinsurer's perceived inability to litigate in a fair setting or matters of public policy.**
3. If the Hague Convention on Choice of Court Agreements, an international treaty on the enforceability of foreign court awards, is agreed upon and ratified, the principles of comity under which a U.S. cedent could enforce its judgment abroad would be codified, **but the Hague Convention is not expected to significantly alter the basic principles of international comity.**
4. In only **three contexts** is a foreign court likely to not enforce a U.S. judgment or arbitral award in the reinsurance context -- where the parties do not follow the contractual dispute resolution procedure; where default has been entered against the reinsurer for failure to post pre-answer security; or where some element of punitive or exemplary damages is sought from the reinsurer.
  - U.S. reinsurance arbitrations often take place on an informal basis pursuant to contract terms that do not require a strict application of the law. The parties, and sometimes the arbitration panel members, consequently do not always strictly follow the terms of the arbitration provisions in the reinsurance agreement. **Failure to strictly comply could result in difficulties in enforcing the award, assuming the reinsurer has timely objected to the non-compliance.** If the terms of the agreement relating to arbitration are followed, enforceability under the New York Convention should be routine.
  - Foreign courts may refuse to recognize a default entered on the basis of non-compliance with the statutory provisions in a number of states that require an unauthorized insurer or reinsurer to post security before filing pleadings in any litigation. **If a U.S. cedent demands security in a litigation,** or seeks it from an arbitral panel, and the reinsurer refuses to post security, claiming financial inability to do so, **there is a danger that,**

**if default is entered and the case is not litigated on the merits, the reinsurer may successfully defend against that judgment in a foreign jurisdiction.**

- With respect to punitive damages, some foreign courts would likely not enforce a punitive or exemplary damage award based on the reinsurer's bad faith conduct and also may refuse to require a reinsurer to indemnify a U.S. cedent for the cedent's bad faith liability to policyholders under an ECO clause. **Since neither of these potential liabilities is one that would typically be collateralized under credit for reinsurance requirements, neither issue is of great relevance to the debate over reduction of collateral requirements.**
5. Our conclusions are limited in two respects. At your direction, we have not addressed the issue of enforceability of judgments against a liquidator or receiver of a non-U.S. reinsurer, as such a review could entail analyzing insolvency laws abroad. We also express no opinion about the enforceability of a judgment granted to a U.S. receiver in an insolvency proceeding in which the receiver, rather than following the terms of dispute resolution in the reinsurance agreement, obtains a judgment against a reinsurer through the insolvency proceeding. **However, it is our opinion that the receiver of a U.S. ceding insurer would have the same rights to enforce a judgment or arbitral award as would the company itself, if the receiver complies with the reinsurance agreement.**

## DISCUSSION

### Accounting Standards For Credit For Reinsurance - NAIC White Paper

At the request of the NAIC's Reinsurance Task Force, the "U.S. Reinsurance Collateral White Paper" (the "White Paper") was submitted to the NAIC and the public in draft form for comment. Its stated purpose is to provide a "balanced synopsis of the historical arguments in favor of and against amending U.S. reinsurance collateral requirements." The draft White Paper provides a comprehensive background on the subject of collateral requirements necessary to take statutory credit for unauthorized reinsurance, the impact collateral requirements have on U.S. ceding companies and unauthorized reinsurers, and the legal and public policy issues involved in a decision to reduce collateral requirements for certain reinsurers who seek to be "approved" as unauthorized reinsurers without the need for 100% collateral. We assume familiarity with the

White Paper and recognize that it is subject to modification. A brief review of key points that are relevant to our analysis follows.

*A U.S. insurer is not permitted to take statutory credit for its ceded reinsurance unless the assuming reinsurer meets one of the following requirements:*

- The reinsurer is licensed in the same state of domicile as the ceding company for a like kind of business.
- The domiciliary insurance department of the ceding company accredits the reinsurer.
- The reinsurer is domiciled and licensed in a state with substantially similar credit for reinsurance laws as the state of the ceding company.
- The reinsurer maintains trust funds in the United States.
- The ceding company withholds funds or obtains security from the reinsurer.

“Unauthorized reinsurers” are those that do not meet one of the first three criteria and can be U.S. or non-U.S. domiciled.

*The collateral requirement of an unauthorized reinsurer is 100% of gross liabilities, including the unearned premium reserve and losses recoverable (both unpaid and incurred but not reported losses). The unauthorized reinsurer may not reduce its collateral obligation for any portion of the risk it has ceded under its own reinsurance protections. If the reinsurer fails or refuses to pay a secured claim when that claim becomes payable under the reinsurance agreement, the ceding company may, after obtaining an award through dispute resolution, collect the deficiency from the collateral. Additional restrictions may apply to certain multi-beneficiary trusts, but in practice, collateral provides security for enforcement.*

The statutory accounting requirements under which a U.S. cedent may take credit for reinsurance also mandate *certain provisions in the reinsurance agreement with an unauthorized reinsurer*. Thus, in addition to posting collateral, the unauthorized reinsurer must agree to:

- Submit to the jurisdiction of a court in the U.S.
- Comply with all requirements necessary to give the court jurisdiction.
- Abide by the final decision of the court or appellate court in the event of appeal.
- Designate a lawful agent for the service of process in any action, suit or proceeding instituted against the unauthorized reinsurer.
- Pay claims to the cedent or its receiver without diminution in the event of insolvency (a provision that also applies to authorized reinsurance).

Many reinsurance agreements also provide for arbitration at a location in the U.S., subject to the jurisdiction of a designated court.

According to the White Paper, the countries to which the largest portion of premium ceded to unauthorized reinsurers are *Bermuda, the United Kingdom, Germany, Switzerland and France, whose legal requirements have been reviewed,*<sup>1</sup> as well as Ireland, Barbados, the Cayman Islands and the Turks and Caicos, for which we have not reviewed any legal opinions and thus offer no opinion. Japan is also one of the top ten domiciles for unauthorized reinsurers; its law on enforceability of U.S. judgments is also not addressed.

*Various proposals to establish an approved list of reinsurers are pending* before the Reinsurance Task Force of the NAIC as well as before NCOIL. According to the White Paper, in the debate over whether to reduce collateral requirements, enforceability of U.S. judgments abroad is one of the most frequently cited obstacles to any reduction in collateral by opponents of such reduction. Accordingly, we have analyzed data available, opinions that have been submitted, and independent research to opine on the enforceability of U.S. judgments in Bermuda, England, Germany, Switzerland and France.

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<sup>1</sup> We have reviewed the law of England and Wales, as the United Kingdom does not have unified law. Most reinsurers from the U.K. would be domiciled in England, however.

## **Basic Procedures - Litigating the Dispute**

In the ordinary course of business, if a reinsurer refuses to pay a loss under a reinsurance agreement, the ceding insurer may initiate a dispute resolution -- an arbitration, in the event the reinsurance contract has a governing arbitration clause, or a lawsuit in the designated forum.

*In the event of an arbitration*, if the ceding insurer obtains an award in its favor, it would typically apply to a federal court having jurisdiction to confirm the award. The federal court will examine the arbitral award under Title 9 of the U.S. Code. The Federal Arbitration Act (“FAA”), 9 U.S.C. §§ 1-16, applies if both insurer and reinsurer are U.S. domiciled; the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“the New York Convention”), 9 U.S.C. § 201-208, applies if the reinsurer is non-U.S. based. The standards of review by the federal court are slightly different, depending on whether the FAA or the New York Convention is applied, as discussed below. Following confirmation, the ceding insurer may collect from the collateral, and if there is no collateral, it will seek to enforce the judgment abroad. The New York Convention would then also be applied in the foreign jurisdiction if the cedent seeks to enforce the arbitral award, as well as the court judgment.

*In the event of litigation of the dispute*, the ceding insurer will obtain a money judgment, assuming it prevails on the merits or by default. A money judgment from a federal court is easily enforceable in federal courts in other states, and a money judgment in one state court is fairly easily enforced in other state courts, pursuant to Full Faith and Credit and certain minor restrictions thereunder. If the reinsurer is non-U.S. based and does not have collateral, proceedings will be commenced in the foreign jurisdiction to enforce the judgment and, until passage of the Hague Convention on Choice of Court Agreements, which is discussed in detail in the White Paper and would provide an international treaty to enforce judgments between foreign countries, the U.S. cedent will rely upon principles of comity to enforce its judgment abroad. If

the reinsurer is in a liquidation process or other receivership proceeding, enforceability of the arbitral award or money judgment will be affected by the insolvency laws of its domiciliary country, which is beyond the scope of this analysis.

*Default judgments in the reinsurance context* arise most often in the face of a pre-answer security statute. For example, under New York Insurance Law § 1213(c)(1), an unauthorized insurer or reinsurer may not respond to a pleading unless it either posts security or can establish that it maintains sufficient funds in the U.S. to secure its potential obligation. Arbitration panels routinely receive requests for an order of security and are deemed by some courts to have the inherent power to order security even without a statutory provision. Failure to post statutory security may result in a default, since the statutes generally preclude the reinsurer from filing responsive papers without the security. A panel's ability to enter default, if it is acting on its inherent power, is not as clear.

If credit for reinsurance accounting changes allow certain approved reinsurers a reduction in the collateral requirements, *pre-answer security statutes may nevertheless impose collateral requirements in disputed cases*. Moreover, as addressed below, if the reinsurer fails to post security, either because it is unable to do so or because it believes the statute would not be enforced in its home country, the U.S. ceding insurer will face a choice as to whether to accept a default and attempt to enforce it abroad or to move forward with a resolution on the merits without security.

### **Enforceability of Judgments Between the States - Full Faith & Credit**

In examining whether courts in other countries will enforce U.S. court judgments, it is useful to compare the process by which U.S. courts enforce judgments issued in other states and

countries. Judgments issued in one state are generally entitled to Full Faith and Credit in another state.<sup>2</sup> Full Faith and Credit requires recognition unless one of the following exceptions are met:

- Fraud.
- Lack of due process.
- Lack of jurisdiction.
- Public policy reasons.<sup>3</sup>

The Full Faith and Credit clause will not require the enforcement of every right conferred by a statute of another state, and will not require the enforcement of a foreign statutory right where such enforcement would involve the intrusion by one court into the public affairs of another state.<sup>4</sup> A recent example is the enactment of laws in some states permitting same-sex marriage which other states will not be required to abide under Full Faith and Credit. However, the public policy exception is not likely to be triggered in cases of a money judgment, and reinsurance awards will generally be easily enforced between states.

### **Enforceability of Foreign Money Judgments in the United States - Comity**

Judgments rendered in a foreign country are reviewed in some states under a uniform statute regarding enforcement of money judgments<sup>5</sup> and in other states on common law principles of comity that, for the most part, are similar to the uniform statute. *The comity principles are also similar to those a foreign court would apply to a U.S. judgment, as discussed below.* There is no treaty or federal statute regarding enforcement of foreign money judgments in the United States, but the White Paper summarizes the international effort which is near to

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<sup>2</sup> Section 1 of Article IV of the United States Constitution.

<sup>3</sup> 16B Am Jur 2d Constitutional Law § 975.

<sup>4</sup> 16B Am Jur 2d Constitutional Law § 982.

<sup>5</sup> The Uniform Foreign Money-Judgments Recognition Act (“UFMJRA”). See, for example, New York Civil Practice Law and Rules 5302 *et. seq.*

ratification. Under the uniform statutes followed by many states, foreign non-tax and non-penal judgments are enforceable, subject to specified mandatory and permissive exceptions. *The mandatory grounds for non-enforcement are:*

- Lack of subject matter jurisdiction.
- Lack of personal jurisdiction in the rendering forum.
- Lack of basic impartiality or due process in the courts of that forum.<sup>6</sup>

*The permissive grounds for non-enforcement are:*

- The defendant did not receive proper notice of the proceedings.
- The judgment was obtained by fraud.
- The cause of action on which the judgment is based is repugnant to a public policy of the state in which enforcement is sought.
- The judgment conflicts with another final and conclusive judgment.
- The judgment is contrary to an agreement between the parties with respect to the applicable forum.
- Jurisdiction was based solely on personal service and the forum was seriously inconvenient.<sup>7</sup>

Case law interpreting the recognition of foreign money judgments under comity suggests that a foreign money judgment should be recognized and enforced where certain safeguards, essentially the same as the uniform standards above, are satisfied. *The comity standards are:*

- Opportunity for a full and fair trial before a court of competent jurisdiction.
- Proper notice to the defendant.
- A judicial system likely to secure impartial administration of justice.
- No indication of fraud in procuring the judgment or other special reason why comity should not allow enforcement of the judgment.<sup>8</sup>

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<sup>6</sup> UFMJRA § 4(a).

<sup>7</sup> UFMJRA § 4(b).

As outlined in the White Paper, *if the Hague Convention is ratified, U.S. law will become uniform, and will be matched by the foreign jurisdictions that also ratify.* The Hague Convention would not appear to dramatically change the current standards outlined above. According to the White Paper, a signatory to the Hague Convention could refuse to enforce the judgment if due process, including proper service of process, was not afforded to the defendant or if public policy in the enforcing country would be incompatible with the award. Fraud in procuring a judgment or evident impartiality would clearly also be excluded from enforcement. On balance, the current status of the law in the U.S. would not appear to be greatly impacted by the U.S. ratifying the Hague Convention. *As addressed below, the enforceability of U.S. judgments in the five countries we have reviewed would also not be changed significantly by the passage of the Hague Convention.*

### **Enforceability of Foreign Arbitral Awards**

While there is no international counterpart to the Full Faith and Credit clause, as yet, *there is a counterpart with respect to arbitral awards -- the New York Convention.* Admittance to an approved list of unauthorized reinsurers should require consideration of whether the domiciliary country of the proposed reinsurer is a party to the New York Convention. The following relevant countries are signatories: the United Kingdom; Bermuda; Germany; France; Switzerland; Ireland; Japan; Barbados; and the Cayman Islands.

While foreign arbitral awards are generally enforceable pursuant to the New York Convention, there are certain enumerated exceptions. *Recognition and enforcement of the award may be refused if:*

- The agreement to arbitrate was not valid under either the governing law or the law of the country where the award was made, or the parties were under some incapacity.

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<sup>8</sup> *Hilton v. Guyot*, 159 U.S. 113, 164 (1895).

- Proper notice was not given of the appointment of the arbitrator or of the proceedings, or a party was unable to present its case.
- The award was outside of this scope of the submission to arbitration.
- The composition of the arbitration panel or the arbitration procedure was not in accordance with the agreement, or was not in accordance with the law of the country where the arbitration took place.
- The award has not yet become binding on the party or has been set aside or suspended.
- The subject matter of the dispute is not capable of settlement by arbitration under the law of the country being asked to enforce the awards.
- It would be contrary to the public policy of the country in which it is sought.<sup>9</sup>

These exceptions appear to be broader than the grounds under which arbitral awards may be challenged under the FAA, which applies only if both insurer and reinsurer are U.S. companies.

*By comparison, the FAA exceptions are:*

- The award was procured by corruption, fraud, or undue means.
- There was evident partiality or corruption in the arbitrators.
- The arbitrators were guilty of misconduct in refusing to postpone the hearing for cause, refusing to hear evidence, or misbehavior by which a party was prejudiced.
- The arbitrators exceeded their powers or failed to render a final award.
- Manifest disregard of the law.

The potential, under the New York Convention, to challenge an award based on the validity of the reinsurance contract, the scope of the award, the composition of the panel, that the arbitration procedure was not in accordance with the agreement, or that the procedure was not in accordance with the law of the country where the arbitration took place, could be significantly different from the scope of review under the FAA. To date, however, U.S. courts have reviewed foreign

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<sup>9</sup> United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958), Article V.

arbitral awards in light of an expressed public policy in favor of international arbitration and, as they would do under the FAA, give wide deference to foreign arbitral decisions.

*Arbitration clauses in reinsurance agreements often provide that the panel need not comply strictly with the law but, rather, should consider industry custom and practice.* Under the FAA, U.S. courts will seldom review whether a panel correctly applied the governing law in the face of provisions of this nature -- the standard is “manifest disregard of the law” and is seldom the basis for a reversal. For example, in *U.S. Life Ins. Co. v. Superior National Ins. Co.*, No. CV 05-678-GLT (C.D. Cal. 2005), the court refused to second guess the arbitration panel’s decision to award the reinsurer less than its full claim for rescission despite the cedent’s concession it withheld material information. It is possible that a foreign court, under public policy review, would find the same award unenforceable unless the contract expressly relieved the arbitrators of a strict application of the law.

Under the New York Convention, a U.S. court has refused to enforce a foreign arbitral award where the parties selected an umpire in a manner different from the one specified in the contract and the court found the panel was not properly constituted. In that case, *Encyclopedia Universalis S.A. v. Encyclopedia Britannica, Inc.* 403 F. 3<sup>rd</sup> 85 (2d Cir 2005), the court also stated that, while the FAA did not apply, the appointment process would likely have resulted in non-enforcement under the FAA standard of arbitrators exceeding their powers. *Since arbitration is a contractual remedy, a U.S. cedent seeking to enforce its rights should strictly follow the contractual procedures to limit any risk of non-enforcement.* We also note the tendency of some U.S. panels to consolidate various disputes between the same parties in the absence of an agreement to do so -- this could cause enforcement problems under the New York Convention

and cedents should be careful to seek a reinsurer's agreement to any consolidation of arbitrations under separate contracts.

*Based on legal opinions from England, Germany and Switzerland and perhaps less so in France, it appears the courts may apply slightly different interpretations of the Convention criteria that a U.S. court would apply, particularly in considering public policy. However, we consider it unlikely that a court in the major jurisdictions to which the vast majority of premiums to unauthorized reinsurers are ceded would determine that enforcing an arbitration award for money damages is against the public policy of that country absent unusual facts, or a clear failure to follow the contract concerning the process for arbitration, or overreaching by the arbitration panel. It should also be considered that, since the New York Convention has been ratified by the U.S. and applies to U.S. awards, if one party is non-U.S. domiciled, it can hardly be said to create barriers to enforcing U.S. awards abroad -- rather the Convention presents a level playing field.*

### **Enforceability of U.S. Court Judgments**

We have reviewed opinions and cases on the enforceability of U.S. judgments in five of the countries on the NAIC list of the countries in which the major assuming reinsurers are domiciled -- England and Wales, France, Germany, Switzerland, and Bermuda. While we have reviewed some information concerning the potential for enforcement of U.S. judgments in other countries, we have not had an opportunity to review either a specific legal opinion or case directly on point in those other countries. *We recommend that no reinsurer be considered for the approved reinsurer list unless U.S. lawmakers/regulators are satisfied that its place of domicile has law similar to the law of the foregoing countries concerning the enforceability of a U.S. judgment in that country.*

With a U.S. judgment in hand, the U.S. insurer may file an action to enforce in the domicile of the reinsurer, or another country in which significant assets are located, according to the procedures of that country. The filing will likely require local counsel and consequently be more involved than enforcing the award of a state or federal court in the court of another state or a federal court sitting in another state, which processes are quite simple.

The countries analyzed in this study, like the United States in its review of both domestic and foreign judgments, will then apply the principles of comity and explore certain issues. *The principles of comity can be summarized as:*

1. Whether the court that issued the judgment had jurisdiction over the defendant.
2. Whether the court proceeding in which the judgment was rendered accorded the defendant with ordinary due process.
3. Whether the judgment was in any way procured by fraud.
4. Whether some public policy of the state in which the enforcing court is sitting prohibits enforcement of this type of judgment.
5. Whether enforceability would offend a sense of “natural justice.”

*If the Hague Convention is ratified, it will assist in enforcement subject to similar exceptions -- lack of due process or fraud/public policy concerns may lead to non-enforcement.*

The first issue involved in comity, jurisdiction over the reinsurer, will not pose a problem, with the possible exception of Switzerland, since the reinsurer has agreed by contract to U.S. jurisdiction. Swiss law might require actual service of process on a Swiss reinsurer pursuant to the international convention, despite the contractual consent to jurisdiction, and the safer practice for a U.S. ceding company pursuing a Swiss reinsurer would be to effect actual service. The third issue, fraud, would be examined in any jurisdiction, of course, and is unlikely to impact reinsurance judgments absent significant wrongdoing by an arbitration panel, which wrongdoing could be also raised under the FAA. *See, e.g., Commercial Union Ins. Co. v. Lines,*

378 F. 3<sup>rd</sup> 204 (2<sup>nd</sup> Cir. 2003) (balancing the public policy favoring arbitration with the public policy to refuse to use court's power to assist fraud). Enforceability overseas would thus be no different than enforceability in the U.S. in such a case.

*The questions of due process, public policy and natural justice raise issues in two contexts that could be relevant in reinsurance disputes -- a default judgment where the reinsurer either does not appear or does not post requisite pre-hearing security, and the enforcement of punitive damages.*

### **Default Judgments and the *Muhl v. Ardra* Decision**

U.S. ceding insurers often rely on *pre-answer security statutes* to force an unauthorized reinsurer to collateralize a disputed claim. This is a very effective tool against a solvent company that simply refuses to pay a claim. If the reinsurer has already collateralized the loss, however, additional security will not likely be required. The effectiveness of this tool is tied to the authority of the court, and the putative authority of an arbitral panel, to enter a default judgment against the reinsurer that does not comply with the security requirement. Based on our analysis of the legal principles that the courts in Bermuda, England, France, Germany, and Switzerland will apply, *there is a significant risk that such a default judgment would not be enforced, particularly where the reinsurer can establish that it did not have sufficient means to post the security in the U.S.*

The only case we have found or been referred to concerning enforceability of a default judgment involved a Bermuda reinsurer and a New York insurer in liquidation.<sup>10</sup> The reinsurer failed to post security and judgment was entered on three contracts, only two of which provided for U.S. jurisdiction. The third contract called for Bermuda venue and an action was commenced

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<sup>10</sup> *Muhl, Superintendent of Insurance of the State of New York, as liquidator, v. Ardra Insurance Company Limited.*, Civil Jurisdiction 1995, No. 484, May 16, 1997; [1997] 6 Re. L.R. 206.

there, leading to an order by the Bermuda court to stay the U.S. proceeding on the third contract. The Bermuda court refused to enforce the U.S. default judgment for two reasons: (1) the liquidator and the New York court had ignored the anti-suit injunction issued by the Bermuda court with regard to one of the reinsurance treaties which had a Bermuda jurisdiction clause in it; and (2) the New York court's refusal to consider the ability of the reinsurer to post security was contrary to "natural justice." The Bermuda court, which looks to English law for direction, had this to say about the English and Bermudan idea of substantial justice:

It is not a question of whether the legislation is unfair or objectionable, but whether the conduct of the particular case was, on its particular facts, contrary to Natural Justice. If it was, I do not think that it matters whether the procedure is derived from statute, case law or the whim of the presiding judge -if it is unfair, the English and Bermudan Courts will not enforce any judgment obtained as a result of it ... In my judgment, it is contrary to substantial or Natural Justice to require a defendant to put up a security as a condition of defending which it cannot meet. I think that this is a common law principle of general application which can be discussed in the case law governing the united range of circumstances in which a defendant under our system can be required to post security. I have principally considered cases under Order 14, under which a defendant against whom summary judgment is refused may nevertheless, if his defenses is 'shadowy', be required to bring into court some or all of the sum claimed. Even in such a case, where there is a judicial determination that his defense is slim, the principle is that a defendant should not be required to bring in more than he can in fact manage.

*The Muhl v. Ardra case would likely be followed on both points by an English court.*

According to the opinion of an English law firm, English courts have refused to enforce foreign judgments in which an English court had previously made rulings between the same parties, and the English principle of "natural justice" applies if a default judgment is entered without a judicial assessment of liability and an arbitrary determination of amount. English courts have not directly addressed the situation that arose in the *Muhl v. Ardra* case -- default under a reinsurance contract for failure to post security based on inability to pay, not lack of proper

judicial formalities. However, the “natural justice” review by an English court would likely find the Bermuda court’s rationale persuasive.

*Courts in France, Germany and Switzerland, as well as in the U.S., would also likely refuse to enforce a default judgment where a prior action was pending and the foreign court appeared to usurp the other’s power.* It is fairly well settled that if the issues resolved in the U.S. court, or any foreign court for that matter, were also subject to litigation in the home jurisdiction, the home jurisdiction is not likely to enforce the U.S. or other foreign court award. In the context of a reinsurance dispute, where the parties have agreed to U.S. venue, this risk appears quite low. As noted, the *Muhl v. Ardra* case involved a separate Bermuda proceeding because one of the three reinsurance contracts provided for Bermuda venue and the liquidator in New York was clearly exceeding his authority by pursuing all three contracts in U.S. courts.

We have little guidance as to whether the entry of a default judgment for the failure of a reinsurer to post security would be enforced in France, Germany or Switzerland. We anticipate that a company near or in liquidation proceedings would assert strenuously, as in the *Muhl v. Ardra* case, the inherent unfairness in such an award. *Clearly, the safer course for the U.S. ceding insurer would be to adjudicate the case on the merits, even if the reinsurer were ordered to post security and failed to do so.*

In the context of reinsurance disputes, a judgment by default is not likely, absent the failure to post security, unless the reinsurer simply decides it will not appear and defend. *If a reinsurer decides, in the face of a binding reinsurance agreement, that it will not appear and defend, we do not anticipate that the courts in Bermuda, England, France, Germany or Switzerland would refuse to enforce the award.* The *Muhl v. Ardra* application of natural justice, requires some inherent unfairness. In a commercial contract requiring the reinsurer to consent to

jurisdiction and service of process, a willful decision to not appear would not likely be condoned. The impact of a liquidation proceeding could, of course, preclude the reinsurer from appearing, and the impact of the liquidation is, as noted, outside the scope of this analysis.

### **Punitive or Multiple Damages and the Public Policy Exception**

*The second area of concern about the enforceability of U.S. judgments abroad relates to punitive damages.* To consider the potential impact of the tendency of many non-U.S. courts to distrust awards from U.S. courts that appear to be overly penal or not based on actual damage, we have looked at the different contexts in which punitive damages can impact reinsurance agreements. In reality, while the public policy of a number of U.S. states and foreign countries precludes a wrongdoer from insuring against punitive damages for its wrongful conduct, and while some foreign courts have refused to acknowledge treble and other exemplary damage awards from U.S. courts, these public policy concerns and cases have little, if any, relevance to the issue of collateral for reinsurance, as addressed below.

*Issues over punitive damages can arise in three contexts.* First, if punitive damages, or other types of penalties, exemplary damages and damage multiples, are awarded against a policyholder of the ceding insurer, and those damages are covered under the insurance contract, it is purely a question of contract law whether those losses may be ceded to the reinsurer. A determination by an arbitral panel or court that the reinsurance contract allows the ceding insurer to cede losses that contain a punitive component as to the underlying policyholder will, from the information we have analyzed, be enforceable in foreign courts. *No decisions appear to question this basic element of contract law and opinions from the German Ministry of Justice and the English Department of Constitutional Affairs support its application in those countries.*

*A second way in which punitive damages can arise is in the rare circumstance where the reinsurer's handling of the reinsurance claim creates liability to the cedent for bad faith*

*conduct.* While arbitration panels seldom award punitive damages, they have the power to do so. U.S. courts may, of course, award punitive damages in certain cases, and have done so. *See Commercial Union v. Seven Provinces Ins. Co.*, 217 F. 3d 33 (1<sup>st</sup> Cir. 2000). Such an award would not fall under the current credit for reinsurance collateral requirements, as it would not be a loss under a reinsurance contract. *Accordingly, the ability of the U.S. cedent to collect punitive damages from the reinsurer, which again will vary by country, is not likely to be affected by the relaxation of collateral requirements.*

*Finally, U.S. ceding insurers may become liable to policyholders for conduct that is determined to have been in bad faith.* Punitive damages or damage multiples may be assessed for this conduct. Many reinsurance agreements provide ECO coverage, which is in the nature of insurance, not reinsurance, coverage for the ceding insurer. If an ECO clause is contained in the reinsurance agreement, the reinsurer has agreed to pay some portion of the punitive award assessed against the ceding insurer. It should be noted that insurers seldom, if ever, post reserves for bad faith claims against them, and thus reinsurers typically are not required to collateralize their obligations to indemnify.

In a number of states, courts have determined that the public policy of the state prohibits a wrongdoer passing on to an insurer the punitive aspect of the wrongdoer's conduct. Other states will enforce an insurance contract that covers punitive damages and would, consequently, allow the enforcement of an ECO clause between insurer and reinsurer. Arbitration panels determining the coverage of an ECO clause often are not required to strictly apply the law, but may follow industry custom and practice. A panel would be less likely to deny an ECO claim as against public policy, even if the insurer is based in a state in which punitive damages are not insurable. However, a court in a state where such damages are not insurable would almost certainly not

enforce an ECO clause. *Assuming that the cedent obtains an award against the reinsurer that includes ECO damages, the public policy of the enforcing country will become an issue in enforceability, and the results may vary by country as they vary in the United States.*

The public policy exception to the New York Convention and the implication of public policy and natural justice under both comity and the proposed Hague Convention will allow foreign courts to exercise their own discretion. An illustrative case, although from a U.S. court, is *Hartford Fire Ins. Co. v. Lloyds*.<sup>11</sup> The Federal District Court for the District of Connecticut was asked by the unauthorized reinsurers to not enforce an arbitration award that included an amount for punitive damages under the ECO clause. Punitive damages had been awarded against the U.S. cedent, Hartford, and Hartford sought indemnification from insurers at Lloyds. The arbitration panel awarded the claimed amount to Hartford, which sought to confirm under the New York Convention. Lloyds argued to set aside the award on the ground that indemnification of punitive damages in any context violated the public policy of the United States. The court rejected this argument, finding that there was no such public policy of the United States, and held that the award was enforceable.

Other courts might reach different results. *The legal opinions from England, Germany and Switzerland suggest that the public policy in those countries is contrary and courts could, consequently, choose to not enforce the punitive award.* In this respect, the enforceability abroad would be more restrictive than enforceability in the U.S., subject to the above caveat that, in some states, the insurer could not cede the ECO loss to the reinsurer due to the state's public policy.

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<sup>11</sup> 1997 U.S. Dist. LEXIS 10858 (D. Conn. 1997).