

## Treaty Tip:

### The Mutual Benefits of Clear Reinsurance Limits

**R**einsurance agreements commonly contain a dollar limit on the liability of the reinsurer. Both the reinsured and the reinsurer benefit from clarity with respect to such limits. The reinsured benefits by knowing with precision the amount of financial risk it has transferred to the reinsurer, and has a better basis for forecasting the amount of and planning for the risk it retains. The reinsurer benefits from knowing the maximum amount of its potential liability, having the ability to make financial plans to ensure that it will be able to pay the limit if called upon to do so and being better able to maximize the amount of reinsurance it can write.

Despite the mutual benefits of such clarity, the liability limit provisions of reinsurance agreements are not always clear. For example, in *Continental Casualty Co. v. MidStates Reinsurance Corp.*, 2014 WL 7166484 (Ill. Ct. App. Dec. 16, 2014), the reinsured sued the reinsurer due to uncertainty as to whether the reinsurer's obligation to pay the reinsured's claim handling expenses were, or were not, subject to the contractual liability limit contained in certain facultative reinsurance certificates. The liability limit provision of some of the reinsurance certificates explicitly provided that the contractual liability limit was inclusive of claims expenses, while the other certificates were silent with respect to this issue. The courts held that the reinsurance certificates were unambiguous with respect to this issue, and that the contractual liability limit encompassed the payment of reimbursement for both losses and expenses.

Regardless of whether one believes that this case was decided correctly, it is clear that the wording of the certificates resulted in uncertainty. The language of the reinsurance certificates led to sufficient doubt with respect to this issue that the parties to the certificates did not agree as to whether claims expenses were subject to the limit, resulting in a lawsuit. If all of the reinsurance certificates had explicitly provided whether or not claims expenses were subject to the contractual liability limit, this dispute, and its attendant expense and business disruption, might have been avoided. Clarity in the drafting of contractual liability limit provisions benefits all parties to reinsurance agreements.



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