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To family and friends for the years of support

JOHN S. DIACONIS

For my wife, Patricia,
and children, John, William, Joseph, and Ava—
I can't thank you enough for your love, encouragement and support.
This book represents your achievement and effort more than mine.

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JOHN S. DIACONIS
DOUGLAS W. HAMMOND
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The body of jurisprudence we call "reinsurance" has a long and storied history. Its beginnings are found in ocean marine insurance, at a time when ocean marine contracts were emerging as an independent instrument of law. Marine is the oldest form of insurance and was indeed the only form of insurance for centuries. Originating in Italy, it spread through other parts of Europe in the thirteenth century. What was most likely the first reinsurance treaty was finalized in the fourteenth century in Italy and involved a marine contract for the shipment of cargo from Genoa, Italy, to Sluis, The Netherlands. Under that treaty, the "direct insurer," Grillo, arranged for other "insurers," Benavia and Maruffo, to assume the risk of shipping cargo from Cádiz, Spain, to Sluis, which was the more hazardous part of the voyage. The agreement was arranged through a broker, Lomellino, acting on behalf of Grillo and legally worked as a sales contract, transferring the risks from the direct insurer to the other insurers. Although these types of agreements may not include the same provisions that constitute a reinsurance contract today, they effectively functioned as one by enabling the direct insurer to be relieved of some of its liability.\(^1\)

Probably due to their rarity, the existence of subsequent reinsurance treaties was not discovered until the mid 1970s. Among the documents found was a contract, written in the early fifteenth century, which was specifically referred to as a "reinsurance treaty." Again covering a shipment of cargo, the agreement was exclusively between the direct insurer and the reinsurer, and thus no contractual relationship existed between the reinsurer and the original insured. Contracts found in the latter half of the fifteenth century are also significant for their use of reinsurance terminology that is used today.\(^2\)

As the size of cargo shipments grew, a system of coinsurance developed to cover the risks. In this system, the sums insured were split according to definite amounts and divided according to random shares, so that the risks could be spread among a group of parties. Insurance centers or exchanges developed to compensate for the sluggishness and inflexibility of the coinsurance process. By and large,

\(^1\) Klaus Gerathewohl, Reinsurance Principles and Practice 649–51 (1980).
\(^2\) Id. at 651–53.
these insurance centers were successful in handling the problem of increasing values in the goods that were insured and helped to make coinsurance the dominant system until the nineteenth century. The growth of industrialization during the nineteenth century made coinsurance impractical because of its inflexibility and paved the way for the reinsurance industry.\textsuperscript{3}

The early nineteenth century marked what were possibly the first reported reinsurance cases in the United States. The first such case was \textit{Hastie v. DePeyster},\textsuperscript{4} which concerned primary insurance coverage with limits of $1,000 issued by Henry Hastie and John Patrick on the brig \textit{Sally} during a voyage from Malaga to New York. After capture, the vessel was sold by the original assured and the loss in the amount of $872.35 was paid, with the loss being reduced by the amount of proceeds from the sale. Hastie and Patrick did not provide immediate notice, nor did they make an immediate abandonment\textsuperscript{5} to the reinsurer, but provided notice and made a formal abandonment in writing only when the original insured sued them. Hastie and Patrick sought recovery from their reinsurer, which declined on the ground that the reinsureds breached “their duty to have given every information that might lessen . . . loss.”\textsuperscript{6} The court rejected the notion that the reinsured must give notice or abandon to the reinsurer as soon as the original insured gives notice or abandons to the reinsured. The court held that the reinsurance contract “obliges the re-assured to act with good faith, but leaves him in all other respects to his own discretion and prudence in admitting or contesting the claim of the first insured.”\textsuperscript{7}

A later case, \textit{New York State Marine Insurance Co. v. Protection Insurance Co.}\textsuperscript{8} concerned the shipment of goods on a vessel traveling from Massachusetts to Amsterdam and back to New York. The vessel was damaged during the voyage, repaired with bottomry funds, and eventually sold by the bottomry bond holders.\textsuperscript{9} The owners of the vessel claimed a total loss from their insurers, who refused to pay. In the suit that followed, the owners only partially recovered for

\textsuperscript{3} Id. at 659–63.
\textsuperscript{4} Hastie v. DePeyster, 3 Cai. R. 190, 194 (N.Y. Sup. Ct. 1805).
\textsuperscript{5} Abandonment is defined as “[a]n insured’s relinquishing of damaged or lost property to the insurer as a constructive total loss.” BLACK’S LAW DICTIONARY 2 (7th ed. 1999).
\textsuperscript{6} Hastie, 3 Cai. R. at 193.
\textsuperscript{7} Id.
\textsuperscript{9} A “bottomry bond” is a bond with the mortgage of a ship as security. See BLACK’S LAW DICTIONARY 170 (7th ed. 1999).
their loss. The insurers then sought indemnification from their reinsurers, who also denied their liability, and the above suit was brought. In deciding whether the reinsurers were bound to pay any part or a portion of the costs and expenses from the prior suit, the court held that a reinsured party is entitled to indemnification of the entire loss borne by it. The court explained that if notice of a pending suit is given to the reinsurers and they remain silent or do not become involved in the suit, they are bound by the results.

Another nineteenth-century case, *New York Bowery Fire Insurance Co. v. New York Fire Insurance Co.*, addressed the question of nondisclosure. The suit involved a fire policy issued to a New York clothing merchant for up to $3,000 in loss. The ceding insurer paid the loss and, having reinsured its entire policy, sought recovery from its reinsurer. Evidently, the ceding insurer had knowledge that the original insured was in bad repute having a number of prior fires. In declaring what would become a long-standing rule in New York, the court held that “[w]hether the omission was the result of mistake or design was not an important inquiry. The assured acts at his peril in withholding information.”

The late nineteenth century also saw a period of growth in the international reinsurance market. Until 1864, reinsurance had been greatly restricted at Lloyd’s. With world trade on the increase, the British government lifted the restrictions, and the Lloyd’s market went on to develop and refine new methods of risk-sharing. Those innovations included what became known as nonproportional reinsurance, where, simply stated, the reinsurer undertook to pay claims in excess of an agreed sum in exchange for a part of the premium. Whereas the reinsurer had previously documented the particulars of each policy and each claim in “a mass of papers,” this riskier yet more streamlined form of reinsurance coverage reduced clerical work and obviated the need for a large staff. The stage was set for a long period of growth and profitability in the industry as a whole.

Perhaps in large part because of its profitability, the reinsurance industry was characterized by informality and collegiality through most of the twentieth century. Many disputes were resolved amicably by agreement. When they were not, parties arbitrated their disputes.

11. *Id.* at 160–61.
13. *Id.* at 207.
before a panel of industry executives in a confidential proceeding. Litigation was rare.

All this changed in the late 1980s and the 1990s. As the stakes increased, some disputes became battles for survival. Arbitrations became more formalized and court decisions increased. And that environment persists today.

From this brief historical background, we proceed to the intricacies of reinsurance law in the twenty-first century.