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Fundamental Concepts in Reinsurance in Latin American Countries

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Adam B. Leichtling and Laura M. Paredes*

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I. INTRODUCTION

One of the first known references to reinsurance, which is often referred to as "insurance for insurance companies," dates back to 1370 in Europe when an insurer covering a maritime shipment from Genoa to Slyus purchased insurance for itself to cover the most dangerous segment of the journey, from Cadiz to Slyus.¹ While this may not actually be the first instance of reinsurance, this example illustrates how reinsurance allows an insurer to transfer all or part of a risk of loss it has assumed to another insurer. Reinsurance thus broadens an insurer's economic capacity, enabling it to distribute the consequences of certain catastrophic losses so it can make new business, just as the original insurance contract broadens an original policyholder's capacity to undertake new projects.

1. CHARTERED INSURANCE INSTITUTE, *MANUAL DE REASEGURO* 11-12 (Editorial Mapfre 3d ed. 1979).

Understanding the role of reinsurance in Latin American countries is becoming increasingly important as economies globalize and governments and private enterprises, such as reinsurance companies, take on the enormous costs and risks of the development projects required for globalization. Currently, by absorbing the major risks involved in globalization, either in whole or in part, reinsurers help stabilize domestic economies in Latin American countries, for instance, by reducing the exposure of Latin American insurers to catastrophic losses and providing more economic solvency and capacity. Thus, in Latin American countries, reinsurance represents a beneficial and even essential mechanism to support the economic development necessary for globalization. Accordingly, most Latin American countries have tried to regulate reinsurance in a general way to permit reinsurers to market their services on terms that are fair for them, for domestic insurers, and for consumers.

Not surprisingly, there are many common legal principles in reinsurance across Latin American countries. But there are also important distinctions in how these countries independently integrate concepts of reinsurance law. Complicating the integration is the fact that these concepts have developed primarily from common law-based and historically prominent reinsurance markets such as the United States and England, while Latin American countries utilize civil code systems. This comment surveys these fundamental reinsurance concepts in Latin American countries, focusing on six Latin American countries as examples.

II. REGULATION OF THE REINSURANCE CONTRACT IN LATIN AMERICAN COUNTRIES

All Latin American countries have codes regulating insurance, and most have codes specific to reinsurance. In most Latin American countries, the general insurance codes may also apply to reinsurance. In addition, depending on whether a Latin American country's insurance or reinsurance law is considered mandatory, much legislation can be overridden by the reinsurance contract itself. Each Latin American country has certain exceptions to this freedom to override insurance legislation with contract terms.² Typically, these exceptions regard those provisions that establish the basic elements of the insurance contract or where a code provision specifically provides that it cannot be overridden.

2. See *infra* Part II.A,C,D.

Even so, it is likely the general insurance law provisions that apply to reinsurance can be modified in favor of terms that are more beneficial to the original policyholder. In some Latin American countries, the reinsurance contract is precluded from overriding any insurance legislation except as specified, while other legislative schemes are silent on this issue, leaving judges and commentators to reach their own conclusions.³

Most Latin American countries have governmental entities responsible for regulating and supervising insurers and reinsurers. These agencies work to ensure that insurers are legally formed, act lawfully, maintain the appropriate liquidity and other financial requirements, and can also punish insurers and reinsurers for violations.⁴ In addition, these entities offer consumer services, including providing information about insurers' and reinsurers' activities, answering questions or providing consultations, and receiving complaints.⁵ These state entities include:

- Argentina – Superintendencia de Seguros de la Nación;
 - Brazil – Superintendencia de Seguros Privados Ministerio de Fazenda;
 - Chile – Superintendencia de Valored y Seguros;
 - Colombia – Superintendencia Financiera de Colombia;
 - El Salvador – Superintendencia Del Sistema Financiero;
 - Guatemala – Superintendencia de Bancos;
 - Mexico – Comisión Nacional de Seguros y Finanzas;
 - Peru – Superintendencia de Banca y Seguros del Peru;
- and

3. See *infra* Part II.

4. Superintendencia de Seguros de la Nación Institutional Information Page (Arg.), <http://portal.ssn.gov.ar/fwcm/> (last visited Feb. 1, 2006); Superintendencia de Seguros Privados Institutional Information Page (Braz.), http://www.susep.gov.br/menususep/apresentacao_susep.asp (last visited Feb. 1, 2006); Superintendencia de Valores y Seguros Institutional Information Page (Chile), http://www.svs.cl/sitio/html/institucional/f_institucional.html (last visited Feb. 1, 2006); Superintendencia Financiera de Colombia Institutional Information Page (Colom.), <http://www.superfinanciera.gov.co/index.htm> (last visited Feb. 1, 2006); Superintendencia del Sistema Financiero Institutional Information Page (El Sal.), http://www.ssf.gob.sv/frm_quienes/qui_quienes_somos.htm (last visited Feb. 1, 2006); Superintendencia de Bancos Institutional Information Page (Guat.), http://www.sib.gob.gt/Informacion_General/mision.php (last visited Feb. 1, 2006); Comisión Nacional de Seguros y Fianzas Institutional Information Page (Mex.), http://portal.cnsf.gob.mx/portal/page?_pageid=1056,1&_dad=portal&_schema=PORTAL (last visited Feb. 1, 2006); Superintendencia de Banca, Seguros Y AFP Institutional Information Page (Peru), <http://www.sbs.gob.pe/PortalSbs/Quienes/Quienes.htm> (last visited Feb. 1, 2006); Superintendencia de Seguros Institutional Information Page (Venez.), <http://www.sudese.gov.ve/misi.php> (last visited Feb. 1, 2006). Some of these agencies also provide this information in both Spanish and English.

5. *Id.*

- Venezuela – Superintendencia de Seguros, Ministerio de Finanzas.⁶

A. Argentina

In Argentina, the reinsurance contract is specifically regulated by four provisions of the insurance law⁷ and the parties' agreements.⁸ The legislation permits reinsurance, but provides that only the ceding insurer is directly obligated to the policyholder and precludes the policyholder from bringing a direct action against the reinsurer.⁹ Additionally, during liquidation of the ceding insurer, the law gives the policyholder priority over the credit balance with the reinsurer.¹⁰ Finally, the general insurance law enumerates which provisions of law cannot be overridden by the parties' agreements, such as those regarding good faith.¹¹

6. See sources cited *supra* note 4.

7. Ley 17.418, art. 159, XXVII A.D.L.A. 39, 7 de Octubre de 1967 (Arg.) ([The insurer can reinsure the risks it insures from the policyholder, but the insurer is the only one obligated to the policyholder. Retrocession contracts and others, through which the reinsurer at the same time insures the assumed risks, are regulated by the provisions of the reinsurance section.] "El asegurador puede, a su vez, asegurar los riesgos asumidos, pero es el único obligado con respecto al tomador del seguro. Los contratos de retrocesión u otros por los cuales el reasegurador asegura, a su turno, los riesgos asumidos, se rigen por las disposiciones de este título."); *Id.* at art. 160 ([The policyholder has no right of direct action against the reinsurer. In case of voluntary or forced liquidation of the ceding insurer, the group of policyholders will have a special privilege over the creditor balance existing between the insurer and the reinsurer.] "El asegurado carece de acción contra el reasegurador. En caso de liquidación voluntaria o forzosa del asegurador, el conjunto de los asegurados gozará de privilegio especial sobre el saldo acreedor que arroje la cuenta del asegurador con el reasegurador."); *Id.* at art. 161 ([In case of voluntary or forced liquidation of the insurer or the reinsurer, all reciprocal debts and credits, regarding the reinsurance contract, will be compensated automatically.] "En caso de liquidación voluntaria o forzosa del asegurador o del reasegurador, se compensarán de pleno derecho las deudas y los créditos recíprocos que existan, relativos a los contratos de reaseguro."); *Id.* at art. 162 ([The reinsurance contract is regulated by the provisions of this section and by those agreed by the parties.] "El contrato de reaseguro se rige por las disposiciones de este título y las convenidas por las partes.").

8. *Id.* at art. 162.

9. *Id.* at art. 159.

10. *Id.* at art. 161.

11. *Id.* at art. 158 ([In addition to the provisions that by letter or nature are total or partially unmodifiable, the following cannot be modified by parties: articles 5, 8, 9, 34 and 38. Also, articles 6, 7, 12, 15, 18 (second paragraph), 19, 29, 36, 37, 46, 49, 51, 52, 82, 108, 110, 114, 116, 130, 132, 135, and 140 can be modified by parties only in favor of the policyholder.] "Además de las normas que por su letra o naturaleza son total o parcialmente inmodificables, no se podrán variar por acuerdo de partes los arts. 5, 8, 9, 34 y 38 y sólo se podrán modificar en favor de los asegurados los arts. 6, 7, 12, 15, 18 ([Segundo] párrafo), 19, 29, 36, 37, 46, 49, 51, 52, 82, 108, 110, 114, 116, 130, 132, 135, y 140.").

B. Brazil

The development and regulation of the reinsurance market in Brazil is quite unique. In 1939, the Brazilian Reinsurance Institute (IRB) was created as a reinsurance monopoly, with private companies precluded from legally offering direct reinsurance.¹² In August 1996, Constitutional Amendment No. 13 was passed to end the IRB monopoly's "rule on authorization and operation of entities of insurance, reinsurance, social security and capitalization, as well as the official body monitoring activities."¹³ Nonetheless, the IRB continued regulating several aspects of reinsurance activity, including deciding if risks could be assumed by foreign insurers in whole or part.¹⁴

On December 20, 1998, Law No. 9.932 was enacted to transfer all IRB responsibilities to the Superintendence of Private Insurance (SUSEP), and end the IRB's original monopoly.¹⁵ Under Law No. 9.932, foreign reinsurers registered with SUSEP were permitted in accordance with the rules issued by the National Council of Private Insurance (Conselho Nacional de Seguros Privados, or CNSP).¹⁶ In addition, under Law No. 9.932, Brazilian reinsurers are to be permitted and are subject to the rules applicable to domestic insurers.¹⁷

In July 2000, however, the Brazilian Supreme Court suspended Law No. 9.932, in a case filed by the IRB workers' union challenging the changes in functions and structure of the IRB.¹⁸ The Court held:

the privatization of the IRB could only take place once the monopoly had transferred its reinsurance regulatory powers to SUSEP, the insurance regulator. . . . This could only be done either through complementary law or through repeal of law No. 9.932 by the National Council of Private Insurance.¹⁹

Thus, the Brazilian reinsurance market remains heavily regu-

12. DURVAL DE NORONHA GOYOS, JR., *LEGAL GUIDE: BUSINESS IN BRAZIL* 143 (Legal Observer Inc. 6th. ed. 2003), available at http://www.brazilcalifornia.com/business_brazil.pdf.

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

19. Lloyd's, *Brazil - Liberalization of Reinsurance*, http://www.lloyds.com/Lloyds_Worldwide/Country_guides/Brazil/Brazil_Quick_reference_guide.htm.

lated by the IRB and the liberalization of the reinsurance market has not yet taken place in Brazil.²⁰

Currently, the primary regulation of the Brazilian insurance market is the “Decreto-Lei 73/66,” which establishes:

1. The central government exclusively regulates and supervises the insurance market;
2. Non-admitted insurance is not allowed;
3. Broker involvement is mandatory for all insurance contracts, although the IRB is the only admitted reinsurer because private companies cannot legally execute direct reinsurance operations in Brazil; and
4. The regulatory body of the insurance market is SUSEP, which is helped in its operational/technical controlling functions by the IRB.²¹

In Brazil, the reinsurance contract does not create a direct relationship between the policyholder and the reinsurer,²² and the insurer is the only entity responsible for claim payment.²³ Thus, reinsurance is only an indirect guarantee to the policyholder by increasing the likelihood the insurer will be able to pay claims. The IRB can be impleaded into a suit as a necessary party where it may be liable to a defendant insurer.²⁴

C. Chile

In Chile, reinsurance law remains very limited. The Commercial Code provides that an insurer can obtain reinsurance, but the reinsurance contract does not extinguish the ceding insurer's obligations to the policyholder and does not provide a policyholder

20. Superintendência de Seguros Privados (SUSEP), Resseguro – Atos normativos, http://www.susep.gov.br/menuresseguro/resseguro_normas.asp (last visited Dec. 1, 2005) ([Until final judgment of the unconstitutional direct action by the Supreme Federal Tribunal, in regards to law 9.932/99, the transfer of functions and powers from the IRB to SUSEP is temporarily suspended due to the suspension of the effect of law 9.932/99, the legal acts in connection with this law are also suspended.] “Até o julgamento final da Ação Direta de Inconstitucionalidade, relativa à Lei 9.932/99, está suspensa temporariamente a transferência de atribuições da IRB-BRASIL Re para a SUSEP, por força da liminar concedida pelo Supremo Tribunal Federal - STF. Por força da suspensão da eficácia da Lei 9.932/99, os atos normativos editados em função da referida Lei também se encontram com sua eficácia suspensa.”).

21. George R. Keller, et al., *The Brazilian Insurance Market*, <http://www.irmi.com/Expert/Articles/2001/Keller05.aspx>.

22. Carlos André Guedes Loureiro, Comment, *Contrato de Seguro*, JUS NAVIGANDI, Feb. 2003, <http://jus2.uol.com.br/doutrina/texto.asp?id=3777>.

23. *Id.*

24. *Id.*

with a right of direct action against the reinsurer.²⁵ Also, the law precludes the reinsurance from altering the terms of the contract formed between the policyholder and the ceding insurer, including the time for payment of claims.²⁶ In addition, Article 84 of Decree No. 251 establishes that if the ceding insurer is insolvent, the policyholder has priority to reinsurance proceeds over other creditors.²⁷

D. Colombia

In Colombia, the Commercial Code establishes that precepts governing insurance contracts also apply to the reinsurance contract in the absence of contrary stipulations.²⁸ The exception to this freedom of contract is that the reinsurance contract cannot override public policy or precepts which are essential to the insur-

25. Cód. Com. art. 523 (LexisNexis, Chile 2005) ([The insurer can reinsure, under similar conditions, the same things it has insured. The reinsurance does not extinguish the ceding insurer's obligations to the policyholder, nor does it provide the policyholder with a right of direct action against the reinsurer. The insurer and the policyholder cannot form a reinsurance contract; but the policyholder can insure the insurance costs and the risk of insolvency of the ceding insurer.] "El asegurador puede hacer reasegurar, a condiciones más o menos favorables que las estipuladas, las mismas cosas que él hubiere asegurado. El reaseguro no extingue las obligaciones del asegurado, ni confiere al asegurado acción directa contra el reasegurador. El asegurador y el asegurado no pueden celebrar un reaseguro; pero el segundo puede hacer asegurar el costo del seguro y el riesgo de insolvencia del primero.").

26. Decree 251, art 28 D.O. (Chile 2004) ([The reinsurance contract does not alter the terms of the contract formed between the policyholder and the ceding insurer, and payment, in case the risk occurs, cannot be deferred because of the reinsurance.] "El reaseguro no altera en nada el contrato celebrado entre el asegurador directo y el asegurado, y su pago, en caso de siniestro, no podrán diferirse a pretexto del reaseguro.").

27. *Id.* at art. 84 ([When the insurer does not transmit its credits and debts to another company, in terms of article 82, the policyholder's credits originating from the insurance contract, will have priority established in article 2427 of the civil code, numeral 5. The reinsurance proceeds will benefit the policyholders over other creditors. The insurers, however, shall contribute to the administration expenses required in case of the bankruptcy or liquidation of the insurance company.] "En el evento de no producirse el traspaso de cartera y negocios, en los términos del artículo 82, el crédito de los asegurados provenientes de los contratos de seguro gozará del privilegio establecido en el artículo 2427 del Código Civil en el Numeral 5. Con todo, los pagos por reaseguros beneficiarán a los asegurados cuyos créditos por siniestro preferirán a cualesquiera otros que se ejercieren en contra del segurador, sin perjuicio de contribuir a los gastos de administración de la quiebra o liquidación, en su caso.").

28. Cod. Com. art. 1136 (Torres, Colom. 1982) ([The provisions of this title, except those related to public policy and those regarding the essential elements of the insurance contract, will be applied to the reinsurance contract only in the absence of contrary stipulations by the parties.] "Los preceptos de este título, salvo los de orden público y los que dicen relación a la esencia del contrato de seguro, sólo se aplicarán al contrato de reaseguro en defecto de estipulación contractual.").

ance contract, such as the time limit to make a claim or to initiate a legal action.²⁹ Likewise, the parties cannot override those Civil and Commercial Code provisions which are of the essence of the insurance contract, such as those relating to the premium, the risk, and the indemnity.³⁰

Under Article 1334, many of the widely-recognized common law reinsurance concepts are specifically adopted. For example, the reinsurer has the same obligations with the ceding insurer as the ceding insurer has with the policyholder, and the reinsurance contract follows the fortunes of the ceding insurance.³¹ However,

29. *Id.* at art. 1081 ([The limitation of the actions derived from the insurance contract on the provisions that regulate it can be ordinary or extraordinary. The ordinary limitation will be two years and will start to run from the moment in which the interested person has had or should have had knowledge of the fact that is the basis of the action. The extraordinary limitation will be five years, applying against any class of persons and will start running from the moment the particular right arises. These periods of time cannot be modified by the parties.] “La prescripción de las acciones que se derivan del contrato de seguro o de las disposiciones que lo rigen podrá ser ordinaria o extraordinaria. La prescripción ordinaria será de dos años y empezará a correr desde el momento en que el interesado haya tenido o debido tener conocimiento del hecho que da base a la acción. La prescripción extraordinaria será de cinco años, correrá contra toda clase de personas y empezará a contarse desde el momento en que nace el respectivo derecho. Estos términos no pueden ser modificados por las partes.”).

30. *Id.* at art. 1045. ([The essential elements of the insurance contract are: 1) The insurable interest; 2) The risk insured; 3) The premium or price of insurance; and 4) The conditional obligation of the insurer. In the absence of any of these elements, the insurance contract will not produce any legal effects.] “Son elementos esenciales del contrato de seguro: 1. El interés asegurable; 2. El riesgo asegurable; 3. La prima o precio del seguro, y 4. La obligación condicional del asegurador. En defecto de cualquiera de estos elementos, el contrato de seguro no producirá efecto alguno.”); Cód. Civ. art. 1501 (Restrepo, Colom. 2004) ([Each contract has essential elements, natural elements, and accidental elements. The essential elements in a contract are those without which the contract produces no legal effects, or without which the contract degenerates into another type of contract; the natural elements of a contract are those that are not essential to it, but understood to belong in the contract without the need of their incorporation through a special clause; and the accidental elements of a contract are those that are not essential or naturally intended, and that are added to a contract through special clauses.] “Se distinguen en cada contrato las cosas que son de su esencia, las que son de su naturaleza, y las puramente accidentales. Son de la esencia de un contrato aquellas cosas, sin las cuales, o no produce efectos alguno, o degenera en otro contrato diferente; son de la naturaleza de un contrato las que no siendo esenciales en él, se entienden pertenecerle, sin necesidad de una cláusula especial; y son accidentales a un contrato aquellas que ni esencial ni naturalmente le pertenecen, y que se le agregan por medio de cláusulas especiales.”).

31. Cód. COM. art. 1134 (Torres, Colom. 1982) ([By virtue of the reinsurance contract, the reinsurer has the same obligations as the ceding insurer with the policyholder or insured, and follows the same fortune of the ceding insurer in the development of the insurance contract, unless bad faith on the part of the ceding insurer is proven, in which case the reinsurance contract will not produce any legal effect. The responsibility of the reinsurer will not cease, in any case, before the end of

under Article 1335, it is recognized that the direct policyholder has no right of direct action against the reinsurer.³²

E. Mexico

In Mexico, reinsurance regulation is contained in Chapter I of the insurance law, which includes the definition and requirements for the legal formation of the insurance contract. The general insurance law defines reinsurance as a contract through which an insurer totally or partially insures a risk that has already been assumed by another insurer.³³ This piece of legislation regulates aspects such as legal constitution, functioning, inspection, vigilance, liquidation proceedings, infractions and crimes of insurance and reinsurance entities in Mexico.³⁴ It also subjects reinsurers to the determinations of the Ministry of Finance and Public Credit and the National Commission of Insurance and Deposits.³⁵ The insurance law also provides that a ceding insurer is the only insurer responsible to the original policyholder in the event of a

the statute of limitations of the actions derived from the insurance contract. These periods of time cannot be modified by the parties.] "En virtud del contrato de reaseguro el reasegurador contrae con el asegurador directo de las mismas obligaciones que éste ha contraído con el tomador o asegurado y comparte análoga suerte en el desarrollo del contrato de seguro, salvo que se compruebe la mala fe del asegurador, en cuyo caso el contrato de reaseguro no surtirá efecto alguno. La responsabilidad del reasegurado no cesará, en ningún caso, con anterioridad a los términos de prescripción del de las acciones que se derivan del contrato de seguro. Estos términos no pueden ser modificado por las partes.").

32. *Id.* at art. 1135. ([The reinsurance contract is not a contract in favor of a third party. The policyholder does not have a right of direct action against the reinsurer, and the reinsurer does not have any obligation to the policyholder.] "El reaseguro no es un contrato a favor de tercero. El asegurado carece, en tal virtud, de acción directa contra el reasegurador, y este de obligaciones para con aquel.").

33. Ley General de Instituciones y Sociedades Mutualistas de Seguros, art. 10, D.O., 13 de Mayo de 2005 (Mex.) ([For purposes of this Law: . . . reinsurance is a contract by virtue of which an insurer assumes a risk totally or partially that has been already covered by another or the remaining part of the damages that exceed the amount insured by the ceding insurer.] "Para los efectos de esta Ley se entiende: . . . Por reaseguro, el contrato en virtud del cual una empresa de seguros toma a su cargo total o parcialmente un riesgo ya cubierto por otra o el remanente de daños que exceda de la cantidad asegurada por el asegurador directo.").

34. *Id.*

35. *Id.* at art. 76. ([The insurance institutions authorized to practice reinsurance or re-bonding exclusively must operate in conformity with the provisions of this chapter (IV, reinsurance), in accordance with the norms established by the Department of Finance and Public Credit and the National Commission of Insurance and Bonds.] "Las instituciones de seguros autorizadas para practicar exclusivamente el reaseguro o el reafianzamiento, ajustarán sus operaciones a lo dispuesto en el presente Título, con las modalidades que establezcan la Secretaría de Hacienda y Crédito Público y la Comisión Nacional de Seguros y Fianzas.").

loss.³⁶

F. Venezuela

Venezuela's insurance law has only five provisions on reinsurance. Under the first, Article 124, reinsurance contracts are governed by the general law and not the insurance law.³⁷ Under Article 125, unless otherwise provided in the insurance contract, the reinsurance contract only creates a legal relationship between the ceding insurer and the reinsurer; and unless otherwise provided in the reinsurance contract, the reinsurer follows the fortunes of the insurer.³⁸ Article 126 requires all treaty reinsurance contracts to be in writing.³⁹ Article 127 provides that in the liquidation of a ceding insurer, the reinsurer is still obligated to pay all the money owed to the ceding insurer after offsetting credits such as indemnities, premiums, and commissions.⁴⁰ Article 128 pro-

36. *Ley Sobre el Contrato de Seguro*, art. 18, D.O., 2 de Enero de 2002 (Mex.), available at http://www.shcp.gob.mx/servs/normativ/leyes/l_scs.pdf ([Even if the insurer reinsures the risks it has covered, the insurer continues being the only one responsible to the policyholder.] "Aun cuando la empresa se reasegure contra los riesgos que hubiere asegurado, seguirá siendo la única responsable respecto al asegurado.").

37. Decreto 1.505 con Fuerza de Ley del Contrato de Seguro, art. 124, (Venez. 2001) ([Contracts formed between insurance and reinsurance companies are regulated by the general law and are not subject to provisions regarding insurance contracts.] "Los contratos celebrados entre empresas de seguros y empresas de reaseguros se rigen por el derecho común y no están sometidos a las disposiciones sobre el contrato de seguro.").

38. *Id.* at art. 125. ([Unless otherwise provided, the reinsurance contract only creates a legal relationship between the insurer and the reinsurer, but the reinsurer follows the fortunes of the insurer regarding the ceded risk in accordance with the terms of the reinsurance contract.] "A menos que se prevea expresamente en el contrato de seguro, el contrato de reaseguro sólo crea relaciones entre la empresa de seguros y la empresa de reaseguros, pero éste sigue la suerte del primero en el riesgo que le hubiese sido cedido, de acuerdo con lo que a tal efecto prevea el contrato de reaseguro.").

39. *Id.* at art. 126. ([The automatic (or treaty) contract of reinsurance of a series of ceded risks should be proven in writing. The cessions to the automatic (or treaty) contract and the facultative reinsurance can be proven by whatever means permitted by the law.] "El contrato automático de reaseguro relativo a una serie de cesiones de riesgos debe probarse por escrito. Las cesiones al contrato automático y los reaseguros facultativos pueden probarse por cualquier medio de prueba admitido por la ley.").

40. *Id.* at art. 127. ([In the event of administrative liquidation of the ceding insurer, the reinsurer must pay all the money owed to the ceding insurer, after offsetting indemnities, premiums, and commissions and whichever other credit is derived with respect to the reinsurance contract.] "En caso de liquidación administrativa del reasegurado, la empresa de reaseguros deberá pagar totalmente las cantidades de dinero que adeude al reasegurado, hechas todas las compensaciones entre indemnizaciones, primas, comisiones y cualquier otro crédito derivado del respectivo contrato de reaseguro.").

vides that during the liquidation of a ceding insurer, policyholders have priority over the other credits the ceding insurer has against the reinsurers, and over other priorities set forth in the Civil Code.⁴¹

III. BASIC PRINCIPLES: GOOD FAITH AND THE FOLLOW-THE-FORTUNES DOCTRINE IN LATIN AMERICAN COUNTRIES

Given that the development of the reinsurance markets in Latin America has been preceded by hundreds of years of common law development, it is not surprising that Latin American countries have adopted the better developed-common law principles. Of course, each country has adopted these well-accepted principles of reinsurance in their own unique fashion. This individualistic approach is readily apparent throughout Latin American countries, even within the most commonly-held reinsurance doctrines of utmost good faith and follow-the-fortunes.

A. *Utmost Good Faith*

The principle of utmost good faith is generally said to require the ceding insurer to reveal to the reinsurer all information and facts that may influence the reinsurer's decision to assume the risk, charge a higher premium, or both.⁴² It also requires the reinsurer, in turn, to exercise its obligation to its ceding insurer in a good faith manner.⁴³ In most Latin American countries, the ceding insurer typically has the same good faith obligations to the reinsurer that the policyholder has to the ceding insurer. How-

41. *Id.* at art. 128. ([In the administrative liquidation of the ceding insurer, policyholders, the insured and beneficiaries have legal priority over the credits the insurer has against the reinsurers, which will prevail over the other priorities established in the civil code, except those credits related to the costs incurred in conservatory or executive measures regarding property in the interest of all the creditors.] "En la liquidación administrativa de la empresa de seguros corresponde a la masa de los tomadores, los asegurados y los beneficiarios, un privilegio sobre los créditos de aquella contra los reaseguradores, el cual se preferirá a todos los demás privilegios establecidos en el Código Civil, con excepción del correspondiente a los gastos hechos en actos conservatorios o ejecutivos sobre muebles en interés común de los acreedores.").

42. Stephen M. Kennedy et al., *Basics of Reinsurance*, in INSURANCE LAW 2004: UNDERSTANDING THE ABC'S, PRACTISING LAW INSTITUTE LITIGATION AND ADMINISTRATIVE PRACTICE COURSE HANDBOOK SERIES, 361, 368-369 (John C. Yang, ed., 2004) (discussing principles governing the reinsurance relationship).

43. *See id.*

ever, there are some variations in how Latin American countries incorporate good faith concepts, such as:

1. In determining when the duty of good faith arises;
2. In determining who has the burden of proving a breach; and
3. In defining the consequences of a ceding insurer's failure to disclose a material fact to its reinsurer, including whether breach will result in rescission of the reinsurance contract.

Generally, in Latin American countries, the obligation of good faith on behalf of the ceding insurer is applied not only in the pre-contractual phase, but also for the duration of the reinsurance contract.⁴⁴ This is because the reinsurer must be able to have complete confidence in the ceding insurer in all aspects of the risk,⁴⁵ including:

1. Providing the reinsurer accurate and complete information about the risks;
2. Appropriately managing the insurance issues with the policyholder; and
3. Acting with diligence in selecting the assumable risks, accepting or rejecting claims, and defending against legal proceedings.⁴⁶

The reinsurer also has a duty of good faith with the ceding insurer throughout the entire reinsurance relationship.⁴⁷ Reinsurers have particular good faith responsibilities when drafting the terms and clauses of the reinsurance contract.⁴⁸ The reinsurer must also act in good faith when determining its *ex-contractu* responsibilities and take into consideration the impact of its decisions on the ceding insurer.⁴⁹

In addition, the reinsurer must act in good faith when covering a risk in the first place, including having the necessary financial ability to make payment of the indemnity in case the risk takes place.⁵⁰ In addition to premiums, the reinsurer must maintain reserves that provide it with enough liquidity and solvency to

44. CARLOS IGNACIO JARAMILLO, *DISTORSIÓN FUNCIONAL DEL CONTRATO DE REASEGURO TRADICIONAL* 53, 55 (1999).

45. *Id.* at 60.

46. *Id.* at 60.

47. *Id.* at 62.

48. *Id.*

49. *Id.*

50. 2 BLANCA ROMERO MATUTE, *EL REASEGURO* 601 (2001).

pay the ceding insurers.⁵¹ These conditions must exist during the entire reinsurance contract and not only when a risk takes place.⁵² As a result, in some reinsurance contracts, the reinsurer agrees through a clause to hold deposits in favor of the ceding insurer to assure compliance with its main obligation: payment of indemnity.⁵³

It is important to consider that the premiums do not represent the monetary value of a risk.⁵⁴ Premiums are the payment to the reinsurer for assuming a particular risk.⁵⁵ The premiums are those sums, coming from all the risks reinsured, that together form the financial basis necessary to compensate the occurrence of an individual risk.⁵⁶

1. Argentina

In Argentina, the principle of good faith applies from the moment negotiations of the reinsurance contract commence and continue throughout the contractual relationship.⁵⁷ Good faith is presumed, with the reinsurer having the burden to prove that the ceding insurer either intentionally, or due to its negligence or fault, did not act in good faith.⁵⁸ Any provisions in insurance or reinsurance contracts will be interpreted in favor of the policyholder.⁵⁹

Argentinean insurance law contains several specific provisions regarding the protection of good faith in the insurance contract.⁶⁰ The law establishes that any false declaration or

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

57. Stirling Leech, Head of Latin American Team, Clyde & Co., Address to the Insurance Institute of London: Insurance and Reinsurance Claims in Latin America (Oct. 21, 1999) (transcript available at www.iilondon.co.uk/pdf/leech.pdf).

58. See JARAMILLO, *DISTORSIÓN*, *supra* note 44, at 60.

59. MACROSUMA, RESUMEN DE LA LEY DE SEGUROS, <http://www.macrosuma.com.ar/servicios/seguros.htm> (last visited Oct. 4, 2005).

60. Leech, *supra* note 57; Ley 17.418, art. 5, XXVII-B A.D.L.A. 1678, 30 de Agosto de 1967 (Arg). ([All false declarations or withholdings of circumstances known by the policyholder to the ceding insurer, even if made in good faith, which are judged to have impeded the contract or would have modified its terms if disclosed to the insurer regarding the risk, nullify the contract. The insurer must impugn the contract within the next three months after finding out the falseness or the reticence.] "Toda declaración falsa o toda reticencia de circunstancias conocidas por el asegurado, aun hechas de buena fe, que a juicio de peritos hubiese impedido el contrato o modificado sus condiciones, si el asegurador hubiese sido cerciorado del verdadero estado del

“reticencia” made by the insured or ceding insurer to the insurer or reinsurer respectively, prior to formation of the contract, makes the entire contract null and void.⁶¹ Those false declarations or “reticencias” must be of the kind that would have prevented the formation of the contract or would have modified its terms if disclosed.⁶² The concept known as “reticencia,” codified in Law No. 17.418, means unwillingness of the policyholder or ceding insurer to communicate all relevant circumstances about the risk.⁶³ The law also allows the insurer or reinsurer to collect premiums retroactively and during the time it claims the “reticence,” if it was made with bad faith.⁶⁴ These provisions are mandatory under the insurance law, meaning that the parties cannot modify them in an insurance contract⁶⁵ or reinsurance contract.⁶⁶

In addition, the good faith principle is supported by Argentinean Civil Code. The Civil Code governs the insurance or reinsurance relationships when there are aspects unregulated or uncovered by insurance law, which is the specific legislation in the field.⁶⁷ The principle of good faith is regulated by the Civil Code in general terms. The Civil Code requires that all contracts be formed, interpreted and executed in good faith based on what the parties understood or should have understood in the exercise of care and foresight.⁶⁸

riesgo, hace nulo el contrato. El asegurador debe impugnar el contrato dentro de los 3 meses de haber conocido la reticencia o falsedad.”); *Id.* at art. 8 ([If the reticence was fraudulent or in bad faith, the insurer has the right to the premiums for past periods and during the time it claims the reticence or false declaration.] “Si la reticencia fuese dolosa o de mala fe, el asegurador tiene derecho a las primas de los períodos transcurridos y del período en cuyo transcurso invoque la reticencia o falsa declaración.”).

61. See Ley 17.418, art. 5, XXVII-B A.D.L.A. 1678, 30 de Agosto de 1967 (Arg).

62. *Id.*

63. *Id.*

64. *Id.* at art. 8.

65. *Id.* at art. 158 ([Besides the provisions that by their terms or nature are totally or partially unchangeable, the following norms cannot be modified by parties: articles 5, 8, 9, 34 and 38] “Además de las normas que por su letra o naturaleza son total o parcialmente inmodificables, no se podrán variar por acuerdo de partes los arts. 5, 8, 9, 34 y 38”).

66. *Id.* at art. 162 ([The reinsurance contract is regulated by the dispositions of this title and those provisions agreed by the parties.] “El contrato de reaseguro se rige por las disposiciones de este Título y las convenidas por las partes.”).

67. Cód. Com. art. 207 (LexisNexis Arg. 2002) ([The civil code, if not modified by this code, is applicable to commercial and business matters.] “El derecho civil, en cuanto no esté modificado por este Código, es aplicable a las materias y negocios comerciales.”).

68. Cód. Civ. art. 1198 (La Ley, Arg. 2003) ([All contracts must be formed, interpreted, and executed in good faith based on what the parties understood or

The consequence of a breach of good faith, under the Civil Code, is the rescission of the contract unless the other party offers to make the effects of the contract equitable.⁶⁹ Both parties may end a reciprocal-obligation contract when one of them fails to comply with their respective obligations.⁷⁰ If at the time of the breach, parties have complied with part of the obligations, these obligations continue being valid and they will produce their legal effects.⁷¹

In addition, when one of the parties has failed to perform an obligation of the contract, the other party may require compliance within fifteen days, unless the parties have expressly agreed to a shorter time period.⁷² In this case, this creditor can ask for pay-

should have understood in the exercise of care and foresight.] "Los contratos deben celebrarse, interpretarse y ejecutarse de buena fe y de acuerdo con lo que verosímilmente las partes entendieron o pudieron entender, obrando con cuidado y previsión.").

69. *Id.* ([In bilateral commutative contracts, and in unilateral onerous contracts and commutative contracts of deferred or continuous execution, if the performance of one of the parties becomes excessively onerous, due to extraordinary or unforeseen events, the prejudiced party can demand the rescission of the contract. The same principle will apply to aleatory contracts when there is an excessive burden to one of the parties caused by circumstances outside the contract. In contracts of continuous execution the rescission does not change the effects already performed. The rescission will not proceed, if the prejudiced party acted with fault or is in breach. The other party can avoid the rescission of the contract by offering to make the effects of the contract equitable.] "En los contratos bilaterales conmutativos y en los unilaterales onerosos y conmutativos de ejecución diferida o continuada, si la prestación a cargo de una de las partes se tornara excesivamente onerosa, por acontecimientos extraordinarios e imprevisibles, la parte perjudicada podrá demandar la resolución del contrato. El mismo principio se aplicará a los contratos aleatorios cuando la excesiva onerosidad se produzca por causas extrañas al riesgo propio del contrato. En los contratos de ejecución continuada la resolución no alcanzará los efectos ya cumplidos. No procederá la resolución, si el perjudicado hubiese obrado con culpa o estuviere en mora. La otra parte podrá impedir la resolución ofreciendo mejorar equitativamente los efectos del contrato.").

70. *Id.* at art. 1204 ([In contracts of reciprocal obligation, it is implicit that both parties may end their resulting obligations in the event one of the contracting parties fails to comply with its respective performance or obligations.] "En los contratos con prestaciones recíprocas se entiende implícita la facultad de resolver las obligaciones emergentes de ellos en caso de que uno de los contratantes no cumpliera su compromiso.").

71. *Id.* ([If at the time of the breach, parties have complied with part of the obligations, these completed obligations shall remain valid and maintain their corresponding legal effects.] "Mas en los contratos en que se hubiese cumplido parte de las prestaciones, las que se hayan cumplido quedarán firmes y producirán, en cuanto a ellos, los efectos correspondientes.").

72. *Id.* ([When one of the parties has failed to perform an obligation of the contract, the other may require compliance with the obligation within fifteen days, unless the parties, by custom or by express agreement, establish a shorter period with payment of damages due to the delay.] "No ejecutada la prestación, el acreedor podrá

ment of damages caused by the debtor's delay.⁷³ If the party does not perform its obligation in the period of time previously established, all the obligations arising out of the contract will be resolved and the creditor will be entitled to payment of damages.⁷⁴

Further, parties can expressly agree to rescind the contract if one of them does not comply with any of its obligations.⁷⁵ Under these circumstances, the rescission will occur automatically and parties will not need to obtain a judge's declaration of the rescission of the contract.⁷⁶ In such an instance, rescission will occur when the interested party communicates its desire to rescind the contract to the party in breach.⁷⁷

During proceedings before a judge, the creditor can call for the rescission of the contract after having first demanded compliance with the contract.⁷⁸ However, if the creditor first asked for rescission of the contract, it cannot then demand compliance with the contract.⁷⁹

2. Brazil

In Brazil, under the new Civil Code, which has been in place since January 2002, good faith is presumed from the moment the

requerir al incumplidor el cumplimiento de su obligación en un plazo no inferior a quince días, salvo que los usos o un pacto expreso establecieran uno menor, con los daños y perjuicios derivados de la demora.”).

73. *Id.*

74. *Id.* ([If the period ends without the at fault party having performed its obligation, all the obligations of contract will be rescinded and the harmed party will have the right to damages.] “Transcurrido el plazo sin que la prestación haya sido cumplida, quedarán resueltas, sin más, las obligaciones emergentes del contrato con derecho para el acreedor al resarcimiento de los daños y perjuicios.”).

75. *Id.* ([Parties can expressly agree to rescind the contract if one of them does not comply with any of its obligations.] “Las partes podrán pactar expresamente que la resolución se produzca en caso de que alguna obligación no sea cumplida con las modalidades convenidas. . . .”).

76. *Id.* ([Under these circumstances, the rescission occurs automatically without judicial intervention.] “En este supuesto la resolución se producirá de pleno derecho.”).

77. *Id.* ([The rescission will take effect when the interested party communicates to the breaching party its desire to voluntarily resolve the contract.] “. . . la resolución . . . surtirá efectos desde que la parte interesada comunique a la incumplidora, en forma fehaciente, su voluntad de resolver.”).

78. *See id.* ([During proceedings before a judge,] [t]he creditor can call for the rescission of the contract even if it has already demanded compliance with the contract.] “[Durante procesos ante el juez] [l]a resolución podrá pedirse aunque se hubiese demandado el cumplimiento del contrato . . .”).

79. *Id.* ([But if the creditor has first asked for resolution of the contract, it cannot then demand compliance with the contract.] “[P]ero no podrá solicitarse el cumplimiento cuando se hubiese demandado por resolución.”).

contract is entered into and throughout the entire contractual relationship.⁸⁰ The reinsurer has the burden of proving lack of good faith during the pre-contractual or contractual phase of the reinsurance contract, just as the ceding insurer has the burden against a policyholder.⁸¹ Under the new Civil Code, the insurer has the right to rescind the contract based on any bad faith omissions or inaccuracies by the policyholder.⁸² Under the previous Civil Code, such a breach of good faith defeated the specific related claim, but did not terminate the insurance policy.⁸³

3. Chile

In Chile, the Commercial Code establishes the policyholder's duty of good faith. It requires the policyholder to act in good faith from the beginning of the contractual relationship through the time of payment of a claim.⁸⁴ Chile follows the concept of

80. Cód. Civ. art. 765 (Carvalho, Braz. 2002) ([The insured and insurer are both obligated to maintain, from the conclusion and execution of the contract, the most strict good faith and veracity regarding the object of the contract and the circumstances and declarations related to it.] "O segurado e o segurador são obrigados a guardar na conclusão e na execução do contrato, a mais estrita boa-fé e veracidade, tanto a respeito do objeto como das circunstâncias e declarações a ele concernentes.").

81. *Id.* at art. 422 ([Parties to a contract are obligated to maintain, from the conclusion of the contract as well as its execution, the principles of good faith and integrity.] "Os contratantes são obrigados a guardar, assim na conclusão do contrato, como em sua execução, os princípios de probidade e boa-fé."); Leech, *supra* note 57.

82. Cód. Civ. art. 766 (Carvalho, Braz. 2002) ([If there is an inaccuracy or omission in the declarations not made in bad faith, the insurer will have the right to rescind the contract or to collect, even after the risk occurs, the difference between the premiums paid and the premiums owed.] "Se a inexactidão ou omissão nas declarações não resultar de má-fé do segurado, o segurador terá direito a resolver o contrato, ou a cobrar, mesmo após o sinistro, a diferença do prêmio."). This paragraph in article 766 was not included in the previous Civil Code, article 1444.

83. Cód. Civ. art. 1444 (Braz. 1916) ([If an insured does not make accurate and complete declarations, omitting circumstances that could influence the acceptance of the proposal or the premium rate, the insured will lose the right to the insurance proceeds, and will have to pay the due premiums.] "Se o segurado não fizer declarações verdadeiras e completas, omitindo circunstâncias que possam influir na aceitação da proposta ou na taxa do prêmio, perderá o direito ao valor do seguro, e pagará o prêmio vencido.").

84. Cód. Com. art. 556 (LexisNexis, Chile 2005) ([The insured is obligated: 1. To sincerely declare all the necessary circumstances to identify the insured object and to appraise the extension of the risks . . .] "El asegurado está obligado: 1. A declarar sinceramente todas las circunstancias necesarias para identificar la cosa asegurada y apreciar la extensión de los riesgos . . . "); *id.* at art. 557 ([The insurance will be rescinded: by false declarations or errors, reticence made by the policyholder about the circumstances that if known by insurer, may have avoided the formation of the insurance contract or caused substantial modifications in its terms . . .] "El seguro se rescinde: 1. Por las declaraciones falsas o erróneas o por las reticencias del

“reticencia,” similar to Argentina⁸⁵ and the consequence of breach of good faith is rescission of the contract,⁸⁶ with the insurer still being entitled to retain or call for the premium.⁸⁷

4. Colombia

In Colombia, the policyholder is required to communicate the circumstances relevant to the risk being insured.⁸⁸ The consequences of a breach of the duty of good faith are determined by the Commercial Code⁸⁹ and by the concept of “reticencia,” which voids

asegurado acerca de aquellas circunstancias que, conocidas por el asegurador, pudieran retraerle de la celebración del contrato o producir alguna modificación sustancial en sus condiciones”); *id.* at art. 1176 ([In regards to the obligations stated in Article 556, numeral 1, the policyholder must inform the insurer when entering into the contract of all relevant circumstances related to the risk being insured and that are known to the policyholder. It is presumed that the policyholder knows all circumstances that it could not ignore during the ordinary course of its business. And, all pertinent declarations about the risks made by the insured to the insurer or its intermediary, during the previous negotiations of the contract are presumed to be true.] “En el caso de las obligaciones señaladas en el número 1 del artículo 556, el asegurado deberá informar cabalmente al asegurador, antes de perfeccionarse el contrato, de toda circunstancia relativa a los riesgos que se propone asegurar y que sea conocida por dicho asegurado. Se presume conocida del asegurado toda circunstancia que él no puede ignorar en el curso ordinario de sus negocios. Asimismo, toda declaración pertinente a los riesgos hecha por el asegurado al corredor o al segurador, durante las negociaciones previas al contrato deberá ser verdadera.”).

85. See *supra* Part III.A.1.

86. Leech, *supra* note 57.

87. Cód. Com. art. 558 (LexisNexis, Chile 2005) ([Pronouncing the nullity or rescission of the insurance due to fraud by the policyholder, the insurer can demand payment of the premium, without prejudice to criminal actions, even if the risk has not occurred.] “Pronunciada la nulidad o la rescisión del seguro por dolo o fraude del asegurado, el asegurador podrá demandar el pago de la prima o retenerla, sin perjuicio de la acción criminal, aunque no haya corrido riesgo alguno.”).

88. Cód. Com. art. 1058 (Torres, Colom. 1982) ([The policyholder is obligated to communicate sincerely all the facts and circumstances that determine the state of the risk, according to the questionnaire proposed by the insurer.] “El tomador está obligado a declarar sinceramente los hechos o circunstancias que determinan el estado del riesgo, según el cuestionario que le sea propuesto por el asegurador.”).

89. *Id.* ([The policyholder is obligated to communicate sincerely all the facts or circumstances that determine the state of the risk, according to the questionnaire proposed by the insurer. The reticence or inaccuracy about the facts or circumstances that, if known by the insurer, would have prevented it from forming the contract, or induced it to stipulate more onerous conditions, will produce the relative nullity of the insurance.] “El tomador está obligado a declarar sinceramente los hechos o circunstancias que determinan el estado del riesgo, según el cuestionario que le sea propuesto por el asegurador. La reticencia o la inexactitud sobre hechos o circunstancias que, conocidos por el asegurador, lo hubieren retraído de celebrar el contrato, o inducido a estipular condiciones más onerosas, producen la nulidad relativa del seguro.”); *Id.* at art. 1060 ([The insured or policyholder, depending on the case, are required to maintain the state of risk. By that virtue, one or the other shall notify the insurer in writing of all unforeseen facts or circumstances that occur after

the contract.⁹⁰ In addition, the policyholder must maintain the same risk conditions during the contract and, if circumstances change, the policyholder must inform the insurer in writing within ten days of the change in risk conditions, or else the contract terminates.⁹¹

In the absence of contrary contractual stipulations, the Commercial Code establishes that the reinsurer has the same obligations with the ceding insurer as the ceding insurer has with the policyholder, unless the ceding insurer's bad faith is proven, in which case the reinsurance contract has no effect.⁹² Code provisions regulating the insurance contract can be overridden by the reinsurance contract, except those provisions which are essential to the insurance contract or regard public policy.⁹³

5. Mexico

In Mexico, the Civil Code provides a legal presumption of good faith.⁹⁴ The insurance law then sets forth the policyholder's duty of disclosure and permits the insurer to avoid the contract if the insurer proves a breach, even if the undisclosed material facts are unrelated to the claim.⁹⁵ The insurance law requires the policy-

the formation of the insurance contract and that, according to the criteria in article 1058, signify the aggravation of the risk or variation of its the identity.] "El asegurado o el tomador, según el caso, están obligados a mantener el estado de riesgo. En tal virtud, uno u otro deberán notificar por escrito al asegurador los hechos o circunstancias no previsibles que sobrevengan con posterioridad a la celebración del contrato y que, conforme al criterio consignado en el inciso lo del artículo 1058, signifiquen agravación del riesgo o variación de su identidad local.).

90. *Id.* at art. 1058.

91. *Id.* at art. 1060.

92. *Id.* at art. 1134 [By virtue of the reinsurance contract, the reinsurer has with the ceding insurer the same obligations that the ceding insurer has contracted with the insured or policyholder and follows the fortune of the ceding insurance contract, unless the ceding insurer's bad faith is proven, in which case the reinsurance contract has no effect.] "En virtud del contrato de reaseguro el reasegurador contrae con el asegurador directo de las mismas obligaciones que éste ha contraído con el tomador o asegurado y comparte análoga suerte en el desarrollo del contrato de seguro, salvo que se compruebe la mala fe del asegurador, en cuyo caso el contrato de reaseguro no surtirá efecto alguno.).

93. *Id.* at art. 1136 ([The provisions of the insurance title, except those related to public policy and those regarding the essential elements of the insurance contract, will be applied to the reinsurance contract in the absence of contrary stipulations by the parties.] "Los preceptos de este título, salvo los de orden público y los que dicen relación a la esencia del contrato de seguro, sólo se aplicarán al contrato de reaseguro en defecto de estipulación contractual.).

94. Leech, *supra* note 57.

95. Ley Sobre el Contrato de Seguro, art 8, D.O, 2 de Enero de 2002 (Mex.) ([The policyholder is obligated to communicate in writing to the insurer, in accordance with the appropriate questionnaire, all the important facts to understand the risk that

holder to notify the insurer of any change in circumstances pertaining to risk.⁹⁶

If there is significant aggravation of the risks, or the policyholder does not notify the insurer of the aggravated risks within 24 hours, the insurer may avoid the contract within fifteen days of being notified of the aggravation of risk or misrepresentations of the policyholder.⁹⁷ Under the insurance law, the insurer's responsibilities terminate fifteen days after it notifies the policyholder of the termination caused by the aggravation of the risk.⁹⁸

could influence the conditions or terms of the contract which the policyholder knows or should know at the moment of formation of the contract.] "El proponente estará obligado a declarar por escrito a la empresa aseguradora, de acuerdo con el cuestionario relativo, todos los hechos importantes para la apreciación del riesgo que puedan influir en las condiciones convenidas, tales como los conozca o deba conocer en el momento de la celebración del contrato."); *Id.* at art. 47 ([Any omission or inaccuracy in declaring the facts referred to in articles 8, 9, and 10 of this law, will allow the insurer to consider rescinding the contract without needing judicial ruling, even if those omissions did not influence the materialization of the risk.] "Cualquier omisión o inexacta declaración de los hechos a que se refieren los artículos 8, 9, y 10 de la presente ley, facultará a la empresa aseguradora para considerar rescindido de pleno derecho {sin necesidad de que medie sentencia judicial} el contrato, aunque no hayan influido en la realización del siniestro.").

96. *Id.* at art. 52 ([The policyholder must communicate to the insurer, the essential aggravations of the risk during the contract, within 24 hours from the moment the policyholder knows about the aggravated risks. If the policyholder omits the notice or causes an essential aggravation of the risk, all the obligations of the insurer will cease automatically.] "El asegurado deberá comunicar a la empresa aseguradora las agravaciones esenciales que tenga el riesgo durante el curso del seguro, dentro de las veinticuatro horas siguientes al momento en que las conozca. Si el asegurado omitiere el aviso o si él provoca una agravación esencial del riesgo, cesarán de pleno derecho las obligaciones de la empresa en lo sucesivo."); *Id.* at art. 53 ([Regarding the effect of the previous article [art. 52] it will be presumed: 1. that the aggravation of the risk is essential, when the omitted fact is important for the appraisal of the risk to the extent that if known by the insurance company when entering into the contract, it would have caused the modification of the contract terms; 2. That the insured knows or should know all the aggravations that result from the acts and omissions of any of its tenants, spouse, descendants or any other person that, with the consent of the insured, inhabits the building or has in its possession the personal property that is the object of the insurance.] "Para los efectos del artículo anterior se presumirá siempre: 1. Que la agravación es esencial, cuando se refiera a un hecho importante para la apreciación de un riesgo de tal suerte que la empresa habría contratado en condiciones diversas si al celebrar el contrato hubiera conocido una agravación análoga; 2. Que el asegurado conoce o debe conocer toda agravación que emane de actos u omisiones de sus inquilinos, cónyuge, descendientes o cualquier otra persona que, con el consentimiento del asegurado, habite el edificio o tenga en su poder el mueble que fuere materia del seguro.").

97. Leech, *supra* note 57.

98. Ley Sobre el Contrato de Seguro, art 56, D.O., 2 de Enero de 2002 (Mex.) ([When the insurer rescinds the contract due to an essential aggravation of the risk, its responsibility will end fifteen days after the date the insurer communicates its decision to the policyholder.] "Cuando la empresa aseguradora rescinda el contrato

6. Venezuela

In Venezuela, the insurance law contains several provisions intended to protect and guarantee good faith regarding primary insurance contracts. However, it is unclear whether these provisions apply to the reinsurance contract because of similarities in nature and character between the insurance and reinsurance agreement.⁹⁹

Venezuelan insurance law provides a presumption of good faith in the formation of the insurance contract.¹⁰⁰ Before the formation of the contract, the policyholder must accurately reveal to the insurer all the relevant circumstances about the risk of which the policyholder is aware which could influence the insurer's estimation of the risk.¹⁰¹ The policyholder must do so reveal the relevant circumstances in a questionnaire it fills out for the insurer or otherwise in accordance with the insurer's requirements.¹⁰²

The policyholder's duty of good faith regarding the description of the risk is also supported by Venezuela's Civil Code.¹⁰³ In fact, one Civil Code provision establishes that a mistake about the object of the contract or about a circumstance that parties consider or should consider essential, based on good faith and the terms of the contract, nullifies the agreement.¹⁰⁴ In addition, false

por causa de agravación esencial del riesgo, su responsabilidad terminará quince días después de la fecha en que comunique su resolución al asegurado.”).

99. See GARY MENDOZA MARTÍNEZ, *EL CONTRATO DE REASEGURO EN EL DERECHO VENEZOLANO* 41 (Roberto Borrero Q. ed., 1991).

100. Decreto con Fuerza de Ley del Contrato de Seguro, Decreto 1.505, art 4, G.O. (Venez. 2001) ([“When necessary to interpret the insurance contract, utilize the following principles: 1. It will be presumed that the insurance contract was formed in good faith.”] “Cuando sea necesario interpretar el contrato de seguro se utilizarán los principios siguientes: 1. Se presumirá que el contrato de seguro ha sido celebrado de buena fe.”); *Id.* at art. 6 ([Insurance is a contract that is consensual, bilateral, onerous, aleatory, good faith, and executory agreement.] “El seguro es un contrato consensual, bilateral, oneroso, aleatorio, de buena fe y de ejecución sucesiva.”).

101. *Id.* at art. 22 ([The policyholder has the duty, before the formation of the contract, to declare with accuracy to the insurer, in accordance with the questionnaire or the requirements indicated by the insurer, all the circumstances known by him that may influence the evaluation of the risk.] “El tomador tiene el deber, antes de la celebración del contrato, de declarar con exactitud a la empresa de seguros, de acuerdo con el cuestionario que ésta le proporciona o los requerimientos que le indique, todas las circunstancias por él conocidas que puedan influir en la valoración del riesgo.”).

102. *Id.*

103. MARTÍNEZ, *supra* note 99, at 41.

104. Cód. Civ. art. 1148 (Baca, Venez. 1997) ([A mistake of fact, nullifies the contract when it affects one of the qualities of the object of the contract or when it affects a circumstance that the parties consider essential, or that should be considered as such, based on good faith and the conditions under which the contract

statements or “reticencias” (unwillingness to tell the truth) made in bad faith by the insured will nullify the contract¹⁰⁵ if the insurer would not have issued the contract otherwise or would have issued the contract with other terms.¹⁰⁶

The reinsurance chapter of the Venezuela insurance law provides that contracts between insurers and reinsurers are governed by the general provisions of the law rather than by the insurance law.¹⁰⁷ Thus, it still remains unclear whether the good faith provisions in the insurance law, and the consequences of a breach of these good faith provisions, apply to reinsurance.

B. *The Follow-the-Fortunes Doctrine*

The “follow-the-fortunes” doctrine requires that the reinsurer follow the ceding insurer’s fortune and pay the ceding insurer whenever the ceding insurer pays a policyholder’s claim.¹⁰⁸ Generally, absent fraud, collusion or a gratuitous payment, the reinsurer can only refuse to pay the ceding insurer if the ceding insurer acted in bad faith consisting of deception, gross negligence or recklessness.¹⁰⁹

In Latin American countries, the “follow-the-fortunes” doctrine is generally applied even in the absence of a written stipulation to that effect in the reinsurance contract.¹¹⁰ Countries such as

was concluded.] “El error de hecho produce la anulabilidad del contrato cuando recae sobre una cualidad de la cosa o sobre una circunstancia que las partes han considerado como esenciales, o que deben ser consideradas como tales en atención a la buena fe y a las condiciones bajo las cuales ha sido concluido el contrato.”).

105. Decreto con Fuerza de Ley del Contrato de Seguro, Decreto 1.505, art 23, G.O. (Venez. 2001) ([All false statements or insinuations of bad faith made by the policyholder, the insured, or the beneficiary, duly proven, will nullify the contract, if they are of the kind that had the insurer known, it would not have issued the contract or would have issued the contract with other terms.] “Las falsedades y reticencias de mala fe por parte del tomador, del asegurado o del beneficiario, debidamente probadas, serán causa de nulidad absoluta del contrato, si son de tal naturaleza que la empresa de seguros de haberlo conocido, no hubiese contratado o lo hubiese hecho en otras condiciones.”).

106. *Id.*

107. *Id.* at art. 124 ([Contracts formed between insurance and reinsurance companies are regulated by the general law and are not subject to provisions regarding insurance contracts.] “Los contratos celebrados entre empresas de seguros y empresas de reaseguros se rigen por el derecho común y no están sometidos a las disposiciones sobre el contrato de seguro.”).

108. KENNEDY, *supra* note 42, at 368-369.

109. *Id.*

110. JARAMILLO, DISTORSIÓN, *supra* note 44, at 75. By way of comparison, whether a United States court may apply the “follow-the-fortunes” doctrine in the absence of an express provision will depend on the relevant state’s laws. *See also* KENNEDY, *supra* note 42, at 368-369 n.35.

Colombia and Ecuador have codified this doctrine to emphasize its importance, avoid misinterpretations of the rule and assure its recognition.¹¹¹ Nonetheless, as discussed below, in some Latin American countries, the "follow-the-fortunes" doctrine may be set aside by control clauses or other clauses, even where the doctrine is codified.

IV. CONTRACT SPECIFIC REINSURANCE CLAUSES AND THEIR CONSEQUENCES IN LATIN AMERICAN COUNTRIES

Over the years, specific contract clauses have been developed internationally with the intent of modifying the traditional reinsurance relationship or specifically addressing a particular issue. The effect or impact of these provisions in Latin American countries has varied. By way of example, we will discuss the varying treatment of the following fairly typical clauses in the Latin American countries:

1. Control clauses;
2. Simultaneous payment clauses;
3. Insolvency clauses; and
4. Cut-through clauses and clauses that give absolute privilege to the terms of the reinsurance contract over the insurance contract conditions.

As reflected here, the impact of these provisions in Latin America varies greatly by country.

A. *Control Clauses*

In general, control clauses are clauses in a reinsurance contract intended to give more power and involvement to the reinsurer to determine the risk, which is traditionally an area left exclusively to the ceding insurer.

For example, control clauses may:

1. Require the ceding insurer to inform the reinsurer of modifications to the underlying insurance contract and materialization of the risk,¹¹²
2. Require the ceding insurer to consult with or give the reinsurer final decisions regarding the adjustment of catastrophes and losses and selection of the adjuster or attorney,¹¹³ or

111. JARAMILLO, *DISTORSIÓN*, *supra* note 44, at 76-79.

112. *Id.* at 111.

113. *See id.* at 119.

3. Give the reinsurer the final decision on acceptance or rejection of a claim or the amount of covered loss.¹¹⁴

Because the applicable codes in Latin American countries require ceding insurers to determine the risk, the amounts insured and paid on claims, and specific policy conditions, control clauses are likely to be considered valid if they are included in the reinsurance contract, but invalid if included in the primary insurance contract.¹¹⁵

114. *Id.* at 129.

115. See Ley 17.418, art. 158, XXVII A.D.L.A. 39, 7 de Octubre de 1967 (Arg.); Cónv. art. 2035 (Carvalho, Braz. 2002) ([Parties' agreements cannot contravene public order provisions, such as the ones established in this code, in order to assure the social function of property and contracts] "Nenhuma convęcao prevalecera se contrariar preceptos de orden publico, tais como os estabelecidos por este Cdigo para assegurar a funcao social da propriedade e dos contratos."); Cd. COM. art. 1162 (Torres, Colom. 1982) ([In addition to the provisions in this section that cannot be modified due to their nature or text, the following articles shall also remain unaltered by parties: 1058 (sections 1, 2, and 4.), 1065, 1075, 1079, 1089, 1091, 1092, 1131, 1142, 1143, 1144, 1145, 1146, 1150, 1154 and 1159. The following provisions can only be modified in favor of the insured, policyholder or beneficiary: 1058 (section 3.), 1064, 1067, 1068, 1069, 1070, 1071, 1078 (section 1.), 1080, 1093, 1106, 1107, 1110, 1151, 1153, 1155, 1160 and 1161.] "Fuera de las normas que, por su naturaleza o por su texto, son inmodificables por la convencin en este ttulo, tendrn igual carcter las de los artculos 1058 (incisos 1o., 2o. y 4o.), 1065, 1075, 1079, 1089, 1091, 1092, 1131, 1142, 1143, 1144, 1145, 1146, 1150, 1154 y 1159. Y slo podrn modificarse en sentido favorable al tomador, asegurado o beneficiario los consignados en los artculos 1058 (inciso 3o.), 1064, 1067, 1068, 1069, 1070, 1071, 1078 (inciso 1o.), 1080, 1093, 1106, 1107, 1110, 1151, 1153, 1155, 1160 y 1161."); Ley Sobre el Contrato de Seguro, art. 193, D.O., 2 de Enero de 2002 (Mex.) ([All the provisions of this law are mandatory, unless they expressly allow their modification.] "Todas las disposiciones de la presente ley tendrn el carcter de imperativas, a no ser que admitan expresamente el pacto en contrario."); Decreto con Fuerza de Ley del Contrato de Seguro, Decreto 1505, art. 2, G.O. (Venez. 2001) ([All the provisions in this Decree are mandatory, unless they expressly provide otherwise. However, all contractual clauses that are more beneficial to the insured, policyholder, or beneficiary are valid.] "Las disposiciones contenidas en el presente Decreto Ley son de carcter imperativo, a no ser que en ellas se disponga expresamente otra cosa. No obstante, se entendern vlidas las clusulas contractuales que sean ms beneficiosas para el tomador, el asegurado o el beneficiario."). In comparison, in Spain, the United States and England, control clauses are generally considered valid and enforceable by courts in reinsurance contracts. Art. 77 de la Ley 50/1980 de Contrato de Seguro, (B.O.E. 1980, 250) (Spain) ([The reinsurance contract, formed between the ceding insurer and other insurers, will not affect the policyholder, who in all cases, will be allowed to request indemnity in totality from the ceding insurer without prejudice to its right of repetition against the reinsurers, by virtue of the reinsurance contract.] "El pacto de reaseguro interno, efectuado entre el asegurador directo y otros aseguradores, no afectar al asegurado, que podr, en todo caso, exigir la totalidad de la indemnizacin a dicho asegurador, sin perjuicio del derecho de repeticin que a este corresponder frente a los reaseguradores, en virtud de pacto interno."); *Id.* at art. 79 ([The mandate established in article 2 of this law will not be applicable to the reinsurance contract. {Article 2 establishes that the dispositions of the insurance law are obligatory}] "No

Some Latin American commentators argue control clauses should always be invalid, whether in the reinsurance contract or the primary insurance contract, because the clauses violate the legal requirement that the primary insurance contract remain independent from the reinsurance contract by permitting a reinsurer to interfere in the contractual relationship between the ceding insurer and its policyholder.¹¹⁶

Control clauses that negatively affect policyholders are very likely to be found unenforceable, for instance, if:

1. There is an unequal contractual relationship or bargaining power;
2. The clause goes against the principle of good faith; and
3. The inequality in the contract is substantial and not unimportant.¹¹⁷

As discussed below, some Latin American countries have specific code provisions precluding control clauses and if these code provisions are mandatory, control clauses are ineffective.

For example, by its terms, Chile's Commercial Code precludes a reinsurer from intervening in the contract between the ceding insurer and the policyholder, and precludes the ceding insurer from delaying payment of claims while awaiting payment by a reinsurer.¹¹⁸ However, since these Code provisions have been interpreted as "not obligatory or mandatory," they can be overridden by the parties.¹¹⁹ On the other hand, Colombia's Commercial Code requires the ceding insurer to pay the policyholder within thirty days after the policyholder has proved the occurrence of the risk.¹²⁰ If the ceding insurer does not comply, interest is also due

será de aplicación al contrato de reaseguro el mandato contenido en el artículo segundo de esta Ley."); JARAMILLO, *DISTORSIÓN*, *supra* note 44, at 137; *see also* Eagle Star Ins. Co. v. JN Cresswell, [2004] EWCA (Civ) 602 (Eng.).

116. JARAMILLO, *DISTORSIÓN*, *supra* note 44, at 128.

117. *Id.* at 148.

118. JARAMILLO, *DISTORSIÓN*, *supra* note 44, at 165 n.98 (citing Decreto con Fuerza de Ley Sobre Compañías de Seguro, Sociedades Anónimas y Bolsas de Comercio, Decreto 251, art 28, D.O., 20 de Mayo de 1935 (Chile) ([The reinsurance does not in any way alter the contract formed between the ceding insurer and the policyholder, and payment, if the risk occurs, cannot be deferred because of the reinsurance.] "El reaseguro no altera en nada el contrato celebrado entre el asegurador directo y el asegurado, y su pago, en casa de siniestro, no podrá deferirse a pretexto del reaseguro.").

119. *Id.*

120. Cód. COM. art. 1080 (Torres, Colom. 1982) ([If the risk takes place, the ceding insurer must make payment of the indemnity within a month after the policyholder has proved the occurrence of the risk to the insurer according to Article 1077. If this period ends and the insurer has not paid, it must pay the policyholder, in addition to

until payment is made.¹²¹ This payment rule is "semi-imperative," meaning that it can be modified, but only to benefit the policyholder.¹²² Therefore, control clauses intending to extend the time would be invalid in Colombia.

In some Latin American countries, the legality of control clauses may depend on whether the country recognizes a difference between insurance for simple risks (*riesgos de masa*) and insurance for large industrial risks (*riesgos industriales*).¹²³ If such a distinction is recognized, the control clauses would be valid only for *riesgos industriales*.¹²⁴

Similarly, this division is very common in European countries where control clauses could be rejected in the case of simple risks.¹²⁵ Simple risks are held by single insureds.¹²⁶ In Europe, the law protects single insureds, who are considered the most vulnerable party in the insurance relationship, by prohibiting the

its obligation, moratorium interest according to maximum legal rate in effect when making payment. The reinsurance contract does not modify the insurance contract formed between the ceding insurer and policyholder, and the opportunity to make payment of the insurance, in case the risk occurs, cannot be deferred because of the reinsurance contract. The policyholder or beneficiary will have the right to claim, instead of the interests mentioned before, payment of damages caused by the ceding insurer's delay.] "El asegurador estará obligado a efectuar el pago del siniestro dentro del mes siguiente a la fecha en que el asegurado o beneficiario acredite, aún extrajudicialmente, su derecho ante el asegurador de acuerdo con el artículo 1077. Vencido este plazo, el asegurador reconocerá y pagará al asegurado o beneficiario, además de la obligación a su cargo y sobre el importe de ella, la tasa máxima de interés moratorio vigente en el momento en que efectuó el pago. El contrato de reaseguro no varía el contrato de seguro celebrado entre tomador y asegurador, y la oportunidad en el pago de este, en caso de siniestro, no podrá diferirse a pretexto del reaseguro. El asegurado o el beneficiario tendrán derecho a demandar, en lugar de los intereses a que se refiere el inciso anterior, la indemnización de perjuicios causados por la mora del asegurador.").

121. *Id.*

122. *Id.* at art. 1162 ([In addition to the provisions in this section that cannot be modified due to their nature or text, the following articles shall also remain unaltered by parties: 1058 (section 1, 2, and 4), 1065, 1075, 1079, 1089, 1091, 1092, 1131, 1142, 1143, 1144, 1145, 1146, 1150, 1154 and 1159. The following provisions can only be modified in favor of the insured, policyholder or beneficiary: 1058 (section 3), 1064, 1067, 1068, 1069, 1070, 1071, 1078 (section 1), 1080, 1093, 1106, 1107, 1110, 1151, 1153, 1155, 1160 and 1161.] "Fuera de las normas que, por su naturaleza o por su texto, son inmodificables por la convención en este título, tendrán igual carácter las de los artículos 1058 (incisos 1, 2 y 4), 1065, 1075 . . . Y sólo podrán modificarse en sentido favorable al tomador, asegurado o beneficiario los consignados en los artículos . . . 1080.").

123. JARAMILLO, DISTORSIÓN, *supra* note 44, at 141.

124. *Id.*

125. *Id.*

126. *Id.*

reinsurer's intervention in the insurance contract.¹²⁷ The objective of this prohibition is to prevent reinsurers from incorporating terms within the insurance contract that favor their own economic interests and are contrary to the interests of the insured.¹²⁸ However, the legal treatment of industrial large risks is significantly different.¹²⁹ In this case, the law does not stop the reinsurer from intervening in the insurance relationship and the autonomy of the parties is respected.¹³⁰ In this situation, the insured is usually a sophisticated party that has the same equal bargaining and economic position as the reinsurer.¹³¹

B. Simultaneous Payment Clauses

Simultaneous payment clauses are clauses typically found in an underlying policy intending to permit the ceding insurer to delay payment until it has received funds from a reinsurer. This can occur even though no contract exists between the reinsurer and the original policyholder.¹³² Generally, the validity of a simultaneous payment clause in Latin American countries depends on whether the country's code provisions regarding the original policyholder are mandatory or permissive, or whether the country's insurance law separates industrial risks (*riesgos de masa*) from simple risks.¹³³

For example, in Argentina, simultaneous payment clauses may be enforced although they violate the basic reinsurance principles that only the ceding insurer is obligated to the policyholder¹³⁴ and that an insurer must accept or reject a claim within thirty days¹³⁵ because these principles are not mandatory.¹³⁶ At

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

132. *Id.* at 162.

133. *Id.* at 165.

134. Ley 17.418, art. 159, XXVII A.D.L.A. 39, 7 de Octubre de 1967 (Arg.) ([The insurer can reinsure the risks it insures, but the insurer is the only one obligated to the policyholder.] "El asegurador puede, a su vez, asegurar los riesgos asumidos, pero es el único obligado con respecto al tomador del seguro.")

135. *Id.* at art. 56 ([The insurer shall communicate its decision of the policyholder's rights within 30 days of receiving complementary information about the occurrence of the risk.] "El asegurador debe pronunciarse acerca del derecho del asegurado dentro de los 30 días de recibida la información complementaria . . ." acerca de la ocurrencia del siniestro.)

136. *See id.* at art. 158 ([In addition to the provisions that by letter or nature are totally or partially unchangeable, the following norms cannot be modified by parties:

least one commentator has observed that the requirement to make payment within thirty days may only lead to a ceding insurer rejecting a claim simply to afford more time to make payment while also avoiding a technical code violation and fine for delayed payment.¹³⁷

In Chile, these simultaneous payment clauses, known as "Z clauses," are enforceable because code provisions protecting the policyholder can be overridden by contract.¹³⁸ In Colombia, on the other hand, because the Commercial Code requires the ceding insurer to pay claims within thirty days from the day the policyholder proves the occurrence of the risk,¹³⁹ simultaneous payment clauses are likely to be held invalid unless the clause can be shown to benefit the policyholder or permits the policyholder to be paid immediately on claims.¹⁴⁰

C. Cut-Through Clauses

Cut-through clauses are clauses that create a direct action in favor of the original policyholder against the reinsurer regardless of the ceding insurer's solvency.¹⁴¹ In the international reinsurance market, cut-through clauses have become common and their insertion in the reinsurance contract may be particularly practical and beneficial for the policyholder.¹⁴² Whether cut-through

articles 5, 8, 9, 34, and 38, and articles 6, 7, 12, 15, 18 (second paragraph), 19, 29, 36, 37, 46, 49, 51, 52, 82, 108, 110, 114, 116, 130, 132, 135, and 140 can only be modified in favor of the policyholder.] "Además de las normas que por su letra o naturaleza son total o parcialmente inmodificables, no se podrán variar por acuerdo de partes los arts. 5, 8, 9, 34 y 38 y sólo se podrán modificar en favor del asegurado los arts. 6, 7, 12, 15, 18 (2o. Párrafo), 19, 29, 36, 37, 46, 49, 51, 52, 82, 108, 110, 114, 116, 130, 132, 135, y 140.")

137. JARAMILLO, *DISTORSIÓN*, *supra* note 44, at 178 n.107.

138. *Id.* at 176 n.105.

139. Cód. Com. art. 1080 (Torres, Colom. 1982).

140. JARAMILLO, *DISTORSIÓN*, *supra* note 44, at 166-167; *see also* Cód. Com. art. 1162 (Torres, Colom. 1982).

141. MATUTE, *supra* note 50, at 795.

142. In Spain, for instance, cut-through clauses may be considered valid because of the autonomy between the parties, and because they benefit policyholders and protect their interests. One argument against the validity of the cut-through clause relies on Article 1.257.1 of the Spanish Civil Code which states that contracts only produce effects between the parties. However, the second part of that Article, 1.257.2, states that if the contract has clauses in favor of third parties, these third parties will be able to require the execution of these clauses so long as they communicate their acceptance of the stipulations to the obligor before the clauses have been revoked. This part of Article 1.257 opens the door for stipulating contract provisions in favor of third parties and permitting third party contract claims. In addition, the insurance law of Spain establishes that the reinsurance contract will not affect the original policyholder (Article 77) and precludes direct action against the reinsurer by the

clauses will be enforced in Latin American countries remains very uncertain. The enforcement of these clauses ultimately depends on how the Latin American courts will resolve the tension between the special protection the clauses offer policyholders¹⁴³ and the law in most Latin American countries that precludes a

original policyholder (Article 78). Some critics argue, therefore, the original policyholder cannot make a claim directly to the reinsurer, but it can receive the payment of the indemnity from the reinsurer. Thus, the possibility of being enforced increases since a cut-through clause may be judged more as credit right than as an indemnity clause. In the United States, enforceability of cut-through clauses depends on state codes and whether they establish that a policyholder has no rights against a reinsurer. *Id.* at 796-800. U.S. states with laws permitting direct payment to the policyholder or to a specifically named payee can essentially be divided into four categories:

- 1) Those permitting payment to another payee, like California, Minnesota, New Jersey, and Ohio;
- 2) Those permitting payment to another payee or to an assignee, like Arizona, Arkansas, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Michigan, Nebraska, Nevada, New Hampshire, New York, North Carolina, Oklahoma, Oregon, Rhode Island, South Carolina, Texas, Utah, Vermont, Virginia, and Washington;
- 3) Those permitting payment to another payee with an assignment, like North Dakota and Pennsylvania; and
- 4) Those permitting payment only to an assignee, like New York.

In most of these states, the relevant statutes have not been interpreted by the courts or the insurance departments. *See* Francine L. Semaya, *Insurance Insolvencies 2002-2003: Is the Industry Prepared?*, in REINSURANCE LAW AND PRACTICE 2002-2003: NEW LEGAL & BUSINESS DEVELOPMENTS IN A CHANGING GLOBAL ENVIRONMENT, at 87, 194 (PLI Commercial Law and Practice, Course Handbook Series No. A0-00EU, 2002). *But see* Semaya, *supra*, at 196 (citing *Koken v. Reliance Ins. Co.*, 784 A.2d 209 (Pa. Commw. Ct. 2001) (permitting direct payments from reinsurers where the reinsurer could provide a signed document showing it had unequivocally undertaken a direct coverage obligation to the original policyholder, and the policyholder consented to payment); *In re Bennet Funding Group, Inc. Sec. Litig. v. Sphere Drake Ins., PLC*, 270 B.R. 126 (S.D.N.Y. 2000) (holding that New York law permits a policyholder to bring suit directly against a reinsurer where there is a cut-through clause)). In addition, certain states have enacted legislation recognizing that a cut-through clause creates an exception to the reinsurer's obligation to pay the estate if the ceding insurer is declared insolvent. *E.g.* FLA. STAT. § 631.205 (2005). "NAIC Model Liquidation Act Section 36 provides that payments by a reinsurer must be made directly to the ceding insurer or its receiver, except where the contract of insurance or reinsurance specifies another payee and this provision is in accordance with the applicable requirements of statutes, rules, or order of the domiciliary state of the ceding insurer." Semaya, *supra*, at 199. In England, prior to the 1999 Contract (Right of Third Parties) Act, cut-through clauses were not enforceable there because original policyholders did not have recognized contract rights, including as a third-party beneficiary. Larry P. Schiffer, *Cut-Through Provisions in Reinsurance Agreements*, International Risk Management Institute, Expert Commentary (March 2001), <http://www.irmi.com/irmicom/expert/articles/2001/schiffer03.aspx>.

143. JARAMILLO, *DISTORSIÓN*, *supra* note 44, at 183, 196.

policyholder from bringing a direct action against a reinsurer.¹⁴⁴

Like in many markets, there are substantial critics in Latin America of cut-through clauses, including those who argue the clauses are unfair to other policyholders whose risk was not reinsured because reinsurance proceeds would pass directly to a reinsured policyholder rather than into the ceding insurer's liquidation estate, leaving less money to pay other policyholders.¹⁴⁵

1. Argentina

In Argentina, cut-through clauses may be enforced,¹⁴⁶ subject to challenge where a ceding insurer is insolvent or if there is a foreign jurisdiction clause in the reinsurance contract.¹⁴⁷ Critics argue cut-through clauses are illegal because they violate several provisions of the insurance law,¹⁴⁸ including that the primary insurer is the only one obligated to the policyholder,¹⁴⁹ and the preclusion of direct right of action against the reinsurer.¹⁵⁰ Supporters of cut-through clauses argue these insurance law provisions which critics claim are violated are actually not mandatory and, therefore, can be modified by the parties' agreement.¹⁵¹ Another argument in favor of cut-through clauses is that they constitute one more guarantee of payment of the insurance indemnity to the policyholder, and the reinsurer becomes a mutually binding debtor if the risk occurs, a situation that favors the policyholder.¹⁵²

2. Brazil

According to recent information from the Brazilian Superintendence of Private Insurance (SUSEP), cut-through clauses cannot be legally incorporated into the reinsurance contract.¹⁵³

144. For a discussion regarding direct action issues in Latin American countries, see *infra* section IV.

145. JARAMILLO, DISTORSIÓN, *supra* note 44, at 188 n.112, 200; MATUTE, *supra* note 50, at 800.

146. Leech, *supra* note 57.

147. *Id.*

148. See Waldo Sobrino, *La Clausula Cut-Through y Su Validez Legal Según la Legislación Vigente*, Estudio Sobrino & Sobrino y Asociados, <http://www.estudio-sobrino.com/espanol/consultora/b.html> (follow "Publicaciones Seguros" hyperlink; then follow "Cut Through" hyperlink) (last visited Jan. 5, 2006).

149. Ley 17.418 art. 159, XXVII A.D.L.A. 39, 7 de Octubre de 1967 (Arg.).

150. See *id.* at art. 160.

151. See Sobrino, *supra* note 148.

152. *Id.*

153. SUSEP, *Resseguro – Perguntas e Respostas*, available at http://www.susep.gov.br/menuresseguro/resseguro_faq.asp (last visited Dec. 1, 2005) ([Reinsurance-

SUSEP's opinion on this issue is based on the provision in law No. 9.932 stating that reinsurers will not respond directly to policyholders regarding reinsurance proceeds.¹⁵⁴ It is important to note, however, that even though this information is currently available to the general public, the effects of law No 9.932 have been temporarily suspended due to an appeal testing its constitutionality which is pending before the Brazilian Supreme Tribunal.¹⁵⁵

3. Colombia

It is uncertain whether courts in Colombia will recognize cut-through clauses.¹⁵⁶ They may be validated as benefiting the interests of the policyholder.¹⁵⁷ Some Colombian commentators also argue cut-through provisions should be enforced because the laws that regulate the reinsurance contract are not imperative and the cut-through provisions are consistent with public policy.¹⁵⁸

4. Venezuela

In Venezuela, cut-through clauses are likely to be validated because the insurance law specifically provides that the parties can contractually override the prohibition against the reinsurance contract only creating a relationship between the insurer and the reinsurer.¹⁵⁹

Answers and Questions. Is it possible to form a reinsurance contract with a cut-through clause? No. According to the single paragraph of article 8 in law 9932, . . . all reinsurers and their intermediaries are not directly liable to the insured for the amount covered by the reinsurance] "É possível a contratação de cobertura de resseguro com cláusula de 'cut-through'? Não. Conforme parágrafo único, art. 8º da lei 9932 . . . 'os estabelecimentos de resseguro e os seus retrocessionários não responderão diretamente perante o segurado pelo montante assumido em resseguro.'").

154. *Id.*

155. See *supra* Part II.B.

156. Leech, *supra* note 52.

157. JARAMILLO, DISTORSIÓN, *supra* note 44, at 200.

158. *Id.* at 197 n.123.

159. Decreto 1.505 con Fuerza de Ley del Contrato de Seguro, art. 125, (Venez. 2001) ([Unless specifically permitted in the insurance contract, the reinsurance contract only creates a legal relationship between the ceding insurer and the reinsurer, but the reinsurer follows the fortune of the ceding insurer regarding the ceded risk, in accordance with the terms of the reinsurance contract.] "A menos que se prevea expresamente en el contrato de seguro, el contrato de reaseguro sólo crea relaciones entre la empresa de seguros y la empresa de reaseguros, pero éste sigue la suerte del primero en el riesgo que le hubiese sido cedido, de acuerdo con lo que a tal efecto prevea el contrato de reaseguro.").

D. Other Clauses

1. Insolvency Clauses

Insolvency clauses require reinsurers to pay the ceding insurer's estate in liquidation if the ceding insurer enters bankruptcy or becomes insolvent,¹⁶⁰ even if the ceding insurer has not yet paid the policyholder.¹⁶¹ Insolvency clauses seek to avoid a windfall by the reinsurer, while also avoiding conflict with principles of independence between the reinsurer and the original policyholder.¹⁶² In the absence of enforceable insolvency clauses, a policyholder's compensation for its claims when its insurer becomes insolvent depends on whether applicable codes provide the policyholder special status or simply apportion the insolvent insurer's assets.¹⁶³ Some Latin American countries may enforce insolvency clauses because these clauses favor the policyholder by avoiding payment delay during a long liquidation process and potential underpayment because of insufficient insurer assets, and thus comport with the spirit and objective of those countries' insurance laws.¹⁶⁴

160. MATUTE, *supra* note 50 at 802.

161. Rizvan Khawar, *Reinsurance and Privity in the Past, Present, and Future: Privity of Contract in Reinsurance and the Contracts (Rights of Third Parties) Act 1999*, 77 TUL. L. REV. 495, 507-09 (2002).

162. *Id.* at 508.

163. JARAMILLO, DISTORSIÓN, *supra* note 44, at 181. For comparison, in Spain, to compensate for the absence of a direct action on behalf of the original policyholder against the reinsurer, the law provides the original policyholder special priority in case of bankruptcy or liquidation of the ceding insurer. Art. 78 de la Ley 50/1980 de Contrato de Seguro (B.O.E. 1980, 250) (Spain) ([In case of voluntary or obligatory liquidation of its insurer, the insured will have a special privilege in the creditors' balance produced by the account between the insurer and the reinsurer] "En caso de liquidación voluntaria o forzosa de su asegurador, gozarán de privilegio especial sobre el saldo del acreedor que arroja la cuenta del asegurador con el reasegurador.").

164. JARAMILLO, DISTORSIÓN, *supra* note 44, at 181. For comparison, in the United States, insolvency clauses are commonly enforced. For example, the New York legislature passed insurance laws that prevent a ceding insurer from using reinsurance recoverable as financial credit without the inclusion of an insolvency clause in the text of the reinsurance contract. Also, some insolvency clauses in the United States establish that a reinsurer may issue cut-through endorsements to the insured of the ceding company. Myra E. Lobel, et al., *Current Issues In Drafting Reinsurance Contracts*, in REINSURANCE LAW & PRACTICE 2003: NEW LEGAL & BUSINESS DEVELOPMENTS IN A CHANGING GLOBAL ENVIRONMENT REINSURANCE LAW AND PRACTICE 2002-2003, at 7, 29-31 (PLI Commercial Law and Practice, Course Handbook Series No. A0-00HN, 2003). A recent Pennsylvania state court held that "policyholders who can show that they have third-party beneficiary rights will be permitted direct access to reinsurance proceeds." Lobel, *supra*, at 29 (citing *Koken v. Legion Ins. Co.*, 831 A.2d 1196, 1248 (Pa. Commw. Ct. 2003)). Finally, in England, the Contracts Act of 1999 abandons the rule of privity and has permitted third-party

2. Clauses Regarding the Prevalence of the Reinsurance Contract Over the Insurance Contract

Clauses regarding the prevalence of the reinsurance contract over the insurance contract require examining the reinsurance policy in order to determine the intent of the insurance policy.¹⁶⁵ Thus, the reinsurer's intent, as expressed in the reinsurance contract, is a basis for determining the intent of the policyholder and ceding insurer in the underlying insurance contract.¹⁶⁶ The validity of these clauses is uncertain in Latin American countries.

Critics argue against enforcing these clauses because:

1. The interests of the original policyholder will be based on the reinsurance contract to which the policyholder is not a party;¹⁶⁷
2. Such a clause would actually reverse the "follow-the-fortune" doctrine, which is an accepted principle in Latin American countries and, in some countries, a codified rule;¹⁶⁸
3. Such a clause would violate the autonomy of the policyholder to determine the terms of its own agreements.¹⁶⁹

Further, these clauses are less likely to be enforced if they negatively affect the interests of the policyholder, although this may depend on whether the country makes a distinction between simple risks and industrial risks (*reisgos de maza*).¹⁷⁰

V. DIRECT ACTION BY POLICYHOLDERS AGAINST REINSURERS IN LATIN AMERICAN COUNTRIES

Similar to most other reinsurance markets, a direct action by a policyholder against a reinsurer is generally not permitted by legal codes in Latin American countries.¹⁷¹ However, courts in

beneficiaries to enforce contracts, so a liquidator of an insolvent ceding insurer may argue the policyholder's claim makes it a third-party beneficiary. Khawar, *supra* note 161, at 499, 508.

165. JARAMILLO, *DISTORSIÓN*, *supra* note 44, at 205-06.

166. *Id.* at 206.

167. *Id.* at 207.

168. *Id.* at 208.

169. *Id.* at 208-09.

170. *See id.* at 210.

171. Ley 17.418, art. 160, XXVII A.D.L.A. 39, 7 de Octubre de 1967 (Arg.) ([The policyholder has no right of direct action against the reinsurer. In case of voluntary or forced liquidation of the ceding insurer, the group of policyholders will have a special privilege over the creditor balance existing between the insurer and the reinsurer] ("El asegurado carece de acción contra el reasegurador. En caso de liquidación voluntaria o forzosa del asegurador, el conjunto de los asegurados gozará de privilegio

Latin American countries have not rejected this possibility with the same strength or vigor as in other markets and there are some principals that make the risk of a direct action more real. For example, in some Latin American countries; such as Argentina, Brazil, Chile, Colombia, Peru and Venezuela, the civil procedure rules permit certain proceedings that result in the policyholder, insurer and reinsurer all being parties to the same lawsuit.

A. Argentina

In Argentina, the insurance law provides that the policyholder does not have a right of direct action against the reinsurer, except in a case of bankruptcy by the ceding insurer when the

especial sobre el saldo acreedor que arroje la cuenta del asegurador con el reasegurador.”); Cód. COM. art. 1116 (Bol. 1994) ([The parties in the reinsurance contract are the ceding insurer and the reinsurer. As such, the reinsurance contract does not give to the policyholder a right of direct action against the reinsurer.] “Las partes en el contrato de reaseguro son el asegurador y el reasegurador. En tal virtud este contrato no confiere al asegurado acción directa contra el reasegurador.”); Cód. COM. art. 523 (LexisNexis, Chile 2005) ([The reinsurance does not extinguish the ceding insurer’s obligations, nor does it confer upon the policyholder a right of direct action against the reinsurer.] “El reaseguro no extingue las obligaciones del asegurador, ni confiere al asegurado acción directa contra el reasegurador.”); Cód. COM. art. 1135 (Torres, Colom. 1982) ([The reinsurance is not a contract in favor of a third party. The policyholder does not have a right of direct action against the reinsurer, and the reinsurer does not have any obligation with the policyholder.] “El reaseguro no es un contrato a favor de tercero. El asegurado carece, en tal virtud, de acción directa contra el reasegurador, y éste de obligaciones para con aquel.”); Cód. COM. art. 87 Del Contrato de Seguro (Corporacion de Estudios y Publicaciones, Ecu. 1963) ([The reinsurance does not modify the ceding insurer’s obligations, nor does it confer upon the policyholder a right of direct action against the reinsurer.] “El reaseguro no modifica las obligaciones asumidas por el asegurador, ni da al asegurado acción directa contra el reasegurador.”); Cód. COM. art. 1500 (Orantes, El Sal. 1992) ([The direct policyholder and the beneficiary do not have any right of action against the reinsurer. The insurer cannot impose any exception based on the reinsurance; even if there is an agreement to the contrary.] “El asegurado directo y el beneficiario no tendrán acción alguna contra el reasegurador. El asegurador no podrá oponer a aquéllos excepción alguna derivada del reaseguro, aun contra pacto expreso en contrario.”); Cód. COM. art. 1023 (Guat. 1999) ([The policyholder or beneficiary does not have any action against the reinsurer(s).] “La persona que tenga el carácter de asegurado directo o de beneficiario, no tendrá acción alguna en contra del reasegurador o los reaseguradores.”). Similar laws are also found in some European countries. *See, e.g.* art. 78 de la Ley 50/1980 de Contrato de Seguro (B.O.E. 1980, 250) (Spain) ([The insured cannot claim directly from the reinsurer any indemnity or legal performance.] “El asegurado no podrá exigir directamente del reasegurador indemnización ni prestación alguna.”); C.c. art. 1929 (Italy 2005) ([The reinsurance contract does not create a relationship between the policyholder and the reinsurer, except for the laws regarding privileges in favor of the group of policyholders.] “Il contratto di riassicurazione non crea rapporti tra l’assicurato e il riassicuratore, salvo le disposizioni delle leggi speciali (1) sul privilegio a foavore della massa degli assicurati.”).

insured can rescind the contract or ask for an indemnity.¹⁷² If the bankrupt, ceding insurer lacks sufficient funds to pay the entire indemnity, then the policyholder can ask for the assignment of the ceding insurer's rights against a reinsurer.¹⁷³

The Code of Civil Procedure permits a policyholder to join the insurer directly in any proceeding against the insured,¹⁷⁴ under the legal process called "*citación en garantía*."¹⁷⁵ In turn, the insurer can join the reinsurer into the same proceedings, under the legal process known as "*citación de terceros*."¹⁷⁶

B. Brazil

In Brazil, the Code of Civil Procedure allows for the joinder of third parties, called "*denunciação da lide*."¹⁷⁷ These third party proceedings frequently involve a policyholder joining its insurer as a co-defendant in proceedings against the policyholder.¹⁷⁸ In turn, the insurer can implead the IRB as reinsurer into the same lawsuit.¹⁷⁹ In addition, a property insurance policyholder suing its insurer is entitled to sue the IRB directly as its reinsurer, regardless of whether the reinsurance contract has a cut-through clause.¹⁸⁰

C. Chile

In Chile, the Commercial Code establishes that the reinsurance neither extinguishes the insurer's obligations nor confers a direct right of action to the original policyholder against the reinsurer.¹⁸¹ However, the insurance law establishes a protection for

172. Ley 17.418, art. 160, XXVII A.D.L.A. 39, 7 de Octubre de 1967 (Arg.).

173. JARAMILLO, *DISTORSIÓN*, *supra* note 44, at 184 n.109.

174. Leech, *supra* note 57; Cód. Pro. Civ. Com. art. 86 (LexisNexis, Arg. 2005) ([At the request of an interested party, the beneficiary can litigate against another person in the same lawsuit, when appropriate, and upon notification.] "A pedido del interesado el beneficio podrá hacerse extensivo para litigar con otra persona en el mismo juicio, si correspondiere, con citación de ésta.").

175. Leech, *supra* note 57.

176. *Id.*

177. Cód. Pro. Civ. arts. 70-76 (de Melo, Braz. 2002).

178. Leech, *supra* note 57.

179. *Id.*

180. *Id.*

181. Cód. Com. art. 523 (LexisNexis, Chile 2005) ([The reinsurance does not extinguish the ceding insurer's obligations to the policyholder and does not provide the policyholder with a right of direct action against the reinsurer.] "El reseguro no extingue las obligaciones del asegurador, ni confiere al asegurado acción directa contra el reasegurador.").

policyholders in case of bankruptcy of the ceding insurer.¹⁸² The law determines that the policyholder's credits have a privilege in relation to other credits. Therefore, the payments of reinsurance proceeds will benefit the policyholders in the first place and have priority over the insurer's other credits.¹⁸³

D. Colombia

In Colombia, the reinsurance provisions of the Commercial Code preclude policyholders from direct action against reinsurers.¹⁸⁴ However, the rules of civil procedure provide two possible methods the reinsurer can be joined or participate in a lawsuit between a policyholder and a ceding insurer: "coadyuvancia" and "llamamiento en garantía."¹⁸⁵

"Coadyuvancia" permits a third-party to join a lawsuit if it has a substantial relationship to one of the parties in a proceeding and might be negatively affected by the court's decision.¹⁸⁶ The third-party or "coadyuvante" can join with or without invitation or

182. Decreto con Fuerza de Ley Sobre Compañías de Seguro, Sociedades Anónimas y Bolsas de Comercio, Decreto 251, art 84, D.O. (Chile 2004) ([Reinsurance proceeds will benefit the policyholder, whose credits will be preferred over any others credits against the insurer, without prejudice to contributing to the administration expenses required in case of the bankruptcy or liquidation of the insurer] "Con todo, los pagos por reaseguros beneficiarán a los asegurados cuyos créditos por siniestro preferirán a cualesquiera otros que se ejercieren en contra del asegurador, sin perjuicio de contribuir a los gastos de administración de la quiebra o liquidación, en su caso.").

183. *Id.*

184. Cód. COM. art 1135 (Torres, Colom. 1982) ([The reinsurance contract is not a contract in favor of a third party. The policyholder has no right of direct action against the reinsurer, and the reinsurer does not have obligations to the policyholder.] "El reaseguro no es un contrato a favor de tercero. El asegurado carece, en tal virtud, de acción directa contra el reasegurador, y éste de obligaciones para con aquel.").

185. Cód. PROC. CIV. art. 52 (Molina et al., Colom. 1990) ([A third-party who has a substantial relationship with one of the parties and can be negatively affected by a ruling, can intervene in the lawsuit if the court has not issued its verdict in a non-appealable case or in a second instance court. . . .] "Quien tenga con una de las partes determinada relación sustancial, a la cual no se extiendan los efectos jurídicos de la sentencia, pero que pueda afectarse desfavorablemente si dicha parte es vencida, podrá intervenir en el proceso como coadyuvante de ella, mientras no se haya dictado sentencia de única o de segunda instancia."); *Id.* at art. 57 ([One who has a legal or contractual right to require from a third party payment of damages or total or partial reimbursement of money because of a payment that it has to make as a result of a judicial ruling can ask the judge to incorporate the third-party into the same lawsuit in order to resolve that situation.] "Quien tenga derecho legal o contractual de exigir a un tercero la indemnización del perjuicio que llegare a sufrir, o el reembolso total o parcial del pago que tuviere que hacer como resultado de la sentencia, podrá pedir la citación de aquél, para que en el mismo proceso se resuelva sobre tal relación.").

186. *Id.* at art. 52.

approval from the other parties.¹⁸⁷ The “coadyuvante” can participate in the collection of proofs and other procedural acts to defend its rights,¹⁸⁸ but only the main parties can sue, settle, or make admissions in the lawsuit.¹⁸⁹

“El llamamiento en garantía” is defined by the Code of Civil Procedure as the right to bring a third-party who has a legal or contractual obligation to make a payment into a lawsuit.¹⁹⁰ Critics may argue that using “llamamiento en garantía” to join a reinsurer would conflict with the reinsurance provisions of the Commercial Code which maintain the independence of the insurance contract from the reinsurance contract. Harmonizing the Codes may be a possibility. However, because the reinsurance provisions can be overridden by agreement, with the exception of issues of public policy and the essence of the insurance contract,¹⁹¹ “llamamiento en garantía” should not implicate public policy issues such as time bar provisions or impact the essence of the insurance contract, including provisions relating to premiums or the risk.¹⁹²

187. LÓPEZ BLANCO HERNÁN, INSTITUCIONES DE DERECHO PROCESAL CIVIL COLOMBIANO 158-59 (Dupré Editores ed. 1997) (1974).

188. Cód. PROC. CIV. art. 52, ¶2 (Molina et al., Colom. 1990) ([This third party can use all the procedural actions permitted to the other party, as long as they are not in opposition to the ones done by that party and they do not imply disposition of the right to litigate.] “El coadyuvante podrá efectuar los actos procesales permitidos a la parte que ayuda, en cuanto no estén en oposición con los de ésta y no impliquen disposición del derecho en litigio.”).

189. *Id.*

190. *Id.* at art. 57.

191. Cód. COM. art. 1136 (Torres, Colom. 1982) ([The provisions of this title, except those related to public policy and those regarding the essential elements of the insurance contract, will be applied to the reinsurance contract in the absence of contrary stipulations by the parties.] “Los preceptos de este título, salvo los de orden público y los que dicen relación a la esencia del contrato de seguro, sólo se aplicarán al contrato de reaseguro en defecto de estipulación contractual.”).

192. Cód. CIV. art. 1501 (Restrepo, Colom. 2004) ([The essential elements in a contract are those without which the contract produces no legal effects, or without which the contract degenerates into another type of contract.] “Son de la esencia de un contrato aquellas cosas, sin las cuales, o no produce efecto alguno, o degeneran en otro contrato diferente. . .”); Cód. COM. art. 1045 (Torres, Colom. 1982) ([The essential elements of the insurance contract are: 1) The insurable interest; 2) The risk insured; 3) The premium or price of insurance; and 4) The conditional obligation of the insurer. In the absence of any of these elements, the insurance contract will not produce any legal effects.] “Son elementos esenciales del contrato de seguro: 1) El interés asegurable; 2) El riesgo asegurable; 3) La prima o precio del seguro; y 4) La obligación condicional del asegurador. En defecto de cualquiera de estos elementos, el contrato de seguro no producirá efecto alguno.”).

E. Mexico

In Mexico, there is no direct right of action by a non-insured, or by a policyholder against a reinsurer.¹⁹³

F. Venezuela

In Venezuela, the insurance law provides that without a contrary stipulation in the insurance contract, the reinsurance contract only creates a relationship between the insurer and the reinsurer.¹⁹⁴ Otherwise, the policyholder has the right to sue the insurer, and the insurer has the right to sue the reinsurer.¹⁹⁵

VI. BRIEF OVERVIEW OF INTERNATIONAL ARBITRATION IN REINSURANCE CONFLICTS

In nearly all reinsurance markets, reinsurance disputes are commonly resolved through arbitration pursuant to either arbitration clauses in the reinsurance contracts or separate agreements.¹⁹⁶ Not surprisingly, the normal preference for arbitration to resolve reinsurance disputes is even greater in Latin American countries because of concerns about the alternative dispute forums. However, parties in Latin American reinsurance contracts have favored arbitration to resolve reinsurance disputes involving Latin America for several reasons.¹⁹⁷ For example, commentators have raised several concerns about obtaining a prompt, just, and impartial judgment Latin American courts.¹⁹⁸ There is

193. Ley Sobre el Contrato de Seguro, art 18, D.O., 2 de Enero de 2002 (Mex.) ([Even if the insurer reinsures the risks it has covered, the insurer continues being the only one responsible to the policyholder.] "Aun cuando la empresa se reasegure contra los riesgos que hubiere asegurado, seguirá siendo la única responsable respecto al asegurado.").

194. Decreto 1.505 con Fuerza de Ley del Contrato de Seguro, art. 125 (Venez. 2001) ([Unless otherwise provided, the reinsurance contract only creates a legal relationship between the insurer and the reinsurer, but the reinsurer follows the fortunes of the insurer regarding the ceded risk in accordance with the terms of the reinsurance contract.] "A menos que se prevea expresamente en el contrato de seguro, el contrato de reaseguro sólo crea relaciones entre la empresa de seguros y la empresa de reaseguros, pero éste sigue la suerte del primero en el riesgo que le hubiese sido cedido, de acuerdo con lo que a tal efectos prevea el contrato de reaseguro.").

195. Leech, *supra* note 57.

196. See ANDREW L. NOGA, ESQ., ENDURANCE REINSURANCE CORPORATION OF AMERICA, THE ANATOMY OF A REINSURANCE ARBITRATION CLAUSE 3 (2004), <http://www.endurance.bm/pdf-bin/Anatomy.pdf>.

197. CARLOS IGNACIO JARAMILLO, SOLUCIÓN ALTERNATIVA DE CONFLICTOS EN EL SEGURO Y EN EL REASEGURO 41, at 37, 364 (1998).

198. *Id.* at 36-51.

also apprehension over the lack of economic resources and technology in the judicial system, corruption or the perception of potential corruption compounded by political affiliations,¹⁹⁹ and educational background of judges or knowledge necessary to decide very technical or specific reinsurance issues.²⁰⁰ Additionally, commentators have observed that Latin American governments and citizens generally accept arbitration as a legitimate method of dispute resolution.²⁰¹

A. *Designating a Forum for the Arbitration*

When drafting an arbitration agreement, parties should consider placing the governing law clause outside the arbitration clause.²⁰² Doing so will make clear that it is a choice of the applicable substantive law, rather than just a choice of procedural law or the law which will determine the validity and effect of the arbitration clause.²⁰³

Commentators also recommend that parties carefully consider selecting the location for the arbitration, so as to select a venue which favors arbitration and permits awards to be enforced.²⁰⁴ Factors to take into account include:

1. Selecting a forum whose awards are enforceable in other countries, like those countries which have implemented the Panama or New York Conventions;²⁰⁵
2. Selecting a forum where arbitration agreements are valid, enforced and encouraged, taking into account, for instance, that under Article V(1)(a) of the New York Convention the validity of an arbitration agreement may be determined by the law of the country where the award was made if parties do not specify the law applicable to the contract;
3. Selecting a forum which offers review of an arbitration

199. *Id.* at 51.

200. *Id.* at 49-50.

201. *Id.* at 39-40.

202. R. Doak Bishop, *A Practical Guide for Drafting International Arbitration Clauses*, 1 INT'L ENERGY L. & TAX'N REV. 16, 36 (2000).

203. *Id.*

204. *See id.* at 26-27.

205. For example, Argentina, Brazil, Chile, Colombia, Mexico and Venezuela have all signed and ratified the Panama and New York Conventions which facilitate the recognition and enforcement of foreign arbitral awards. Inter-American Convention on International Commercial Arbitration, Jan. 30, 1975, Sen. Treaty Doc. 97-12, 1438 U.N.T.S. 245 [hereinafter Panama Convention]; Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3 [hereinafter New York Convention].

award on desired bases, and where the courts will enforce foreign awards, because the chosen forum is a likely venue where a petition to enforce or vacate the award may be filed;

4. Selecting a forum which permits a non-national attorney to participate in the arbitration as counsel, taking into account that certain countries require lawyers be authorized to practice in the venue to participate in the arbitration; and
5. Selecting a forum which does not limit the parties' choice of arbitrators.²⁰⁶

B. Designating Arbitrator Selection

When drafting an arbitration agreement, the parties should give consideration to the process of arbitrator selection.²⁰⁷ Arbitrations are frequently done with three arbitrators; two chosen by the parties, and one who is selected by the two party-selected arbitrators.²⁰⁸ The parties can also specify qualifications for the arbitrators, such as requiring they be experts in reinsurance, or specifying how independent they must be from the parties.²⁰⁹

Consideration should be given to adopting rules for the arbitration from an arbitration organization such as the International Chamber of Commerce (ICC), The International Centre for settlement of Investments Disputes (ICSID), the London Court of International Arbitration (LCIA), the AIDA Reinsurance and Insurance Arbitration Society (ARIAS-US) or the American Association of Arbitration (AAA).²¹⁰ Often, those organizations also have standards or rules relating to arbitrator neutrality and ethics.²¹¹ Adopting the rules from these organizations may smooth the arbitration process and avoid pitfalls of ad hoc arbitration, where the arbitrators must manage the negotiation, and make determinations such as the time to render a decision, the amount of discovery, and evidence that is allowed.²¹² Many commentators recommend having an institution administer the arbitration, including administrative and procedural matters and pre-hearing proceedings, as a way to make the arbitration process more effi-

206. See *id.* at 27.

207. See generally Brian Winn & Earl Davis, *Arbitration of Reinsurance Disputes: Is There a Better Way?*, DISP. RESOL. J., Aug.-Oct. 2004, at 22.

208. *Id.* at 22.

209. *Id.*

210. See *id.* at 24-25.

211. See *id.* at 24.

212. See *id.* at 25.

cient and economical.²¹³

Due to the technicalities and complexity of reinsurance contracts, it is in the parties' best interest to select experts in the field that are familiar with the uses, customs and trends of the reinsurance market as arbitrators.²¹⁴ In many cases, these experts are not lawyers, but people who are part of the reinsurance industry that have valuable knowledge about its development.²¹⁵ Also, it is very useful when parties can decide the language applicable to the arbitral proceedings without having to apply the language of the arbitration forum. Doing so will help the parties avoid limitations in the selection of the arbitral panel and their representatives.

Arbitration laws in most Latin American countries do not require arbitrators to be lawyers in order to participate in the arbitral proceedings. Any person can be an arbitrator if chosen by the parties. In Argentina, Brazil, and Mexico, parties can choose arbitrators that are not law practitioners.²¹⁶ Also, these countries are signatories of the Panama Convention which establishes that parties can determine the method of selecting arbitrators and their selection can be delegated to a third party.²¹⁷ Furthermore, arbitrators can be nationals or foreigners under the Panama Convention.²¹⁸

In Chile, Colombia and Venezuela, arbitrators must be attorneys in order to decide a case based on strict rules of law.²¹⁹ How-

213. *Id.*

214. JARAMILLO, SOLUCIÓN, *supra* note 197, at 368.

215. *Id.* at 372.

216. CÓD. PRO. CIV. COM. art. 743 (LexisNexis, Arg. 2005) ([The arbitrators will be selected by the parties, with the third designated by the parties or by the other two arbitrators, if they have authority to do so. If the parties do not agree, the arbitrators will be selected by a competent judge. In order to be arbitrator, a person has to be older than eighteen years old and should be able to exercise all his or her civil rights.] "Los árbitros serán nombrados por las partes, pudiendo el tercero ser designado por ellas, o por los mismos árbitros, si estuviesen facultados. Si no hubiese acuerdo, el nombramiento será hecho por el juez competente. La designación sólo podrá recaer en personas mayores de edad y que estén en el pleno ejercicio de derechos civiles"); Lei No. 9.307, art. 13, 23 de Setembro de 1996 (Braz.) ([An arbitrator can be any legally competent person who has the confidence of the parties] "Pode ser árbitro qualquer pessoa capaz e que tenha a confiança das partes."); see CÓD. COM. arts. 1426-1431 (Castrillón, Mex. 2002) This section on the Composition of the Arbitral Tribunal in the Mexican Commercial Code is silent as to any requirement that an arbitrator be a legal practitioner.

217. Area de Libre Comercio de las Américas (ALCA), *Grupo de Negociación sobre Solución de Controversias: Cuestionario Argentina*, http://www.ftaa-alca.org/busfac/comarb/argentina/quesarg_s.asp (last visited January 1, 2006).

218. *Id.*

219. CÓD. ORG. TRIBUN. art. 225 (LexisNexis, Chile 2005) ([Arbitrators must be lawyers (where their decision is to be based on rules of law)] "El nombramiento de

ever, there is a specific law in Colombia that allows parties to freely agree on the selection of arbitrators and their nationality in matters governed by international arbitration.²²⁰ In Colombia, there are three kinds of arbitration: 1) arbitration based on the application of rules of law, 2) arbitration in equity, and 3) technical arbitration.²²¹ Arbitrators do not need to be lawyers to participate in technical arbitration and arbitration in equity.²²²

In Chile, arbitrators acting as *amiable compositeurs* do not need to be attorneys.²²³ *Amiable compositeurs* in Chile are allowed to resolve the controversy based on equity.²²⁴ They may

árbitros de derecho sólo puede recaer en un abogado.”); Decreto 1818, art. 115 (Colom. 1998) ([Arbitration can be based on strict rules of law, it can be decided in equity or it can be technical. Arbitration based on rules of law is that which the arbitrators base their decision on the rules of law in force. In this case the arbitrator should be a licensed lawyer.] “El arbitraje puede ser en derecho, en equidad o técnico. El arbitraje en derecho es aquel en el cual los árbitros fundamentan su decisión en el derecho positivo vigente. En este evento el árbitro deberá ser abogado inscrito.”); Cód. Proc. Civ. art. 619 (Vadell Hermanos, Venez. 1986) ([An arbitrator who is not a lawyer cannot decide a case based on strict rules of law.] “No pueden ser árbitros de derecho quienes no sean abogados en ejercicio.”).

220. Ley 315, art. 2, 16 de Septiembre de 1996 (Colom.) ([International Arbitration shall be regulated by the provisions of this law, in particular, by the terms of Treaties, Conventions, Protocols and other acts of International Law signed and ratified by Colombia, which will prevail over the rules regarding this matter established in the Code of Civil Procedure. However, parties are free to determine the substantial law arbitrators shall apply in resolving the litigation. They can also determine, by themselves or through the application of pre-established arbitration rules, all procedural aspects of the arbitration including the notice, agreement, procedures, language, the selection and nationality of the arbitrators, just as they can establish the forum of the arbitration that can be in Colombia or in a foreign country.] “El arbitraje internacional se regirá en todas sus partes de acuerdo con las normas de la presente ley, en particular por las disposiciones de los Tratados, Convenciones, Protocolo y demás actos de Derecho Internacional suscritos y ratificados por Colombia, los cuales priman sobre las reglas que sobre el particular se establecen en el Código de Procedimiento Civil. En todo caso, las partes son libres de determinar la norma sustancial aplicable conforme a la cual los árbitros habrán de resolver el litigio. También podrán directamente o mediante referencia a un reglamento de arbitraje, determinar todo lo concerniente al procedimiento arbitral incluyendo la convocatoria, la constitución, la tramitación, el idioma, la designación y nacionalidad de los árbitros, así como la sede del Tribunal, la cual podrá estar en Colombia o en un país extranjero.”).

221. See Decreto 1818, art. 115 (Colom. 1998).

222. *Id.*

223. See Cód. Org. Tribun. art. 225 (LexisNexis, Chile 2005).

224. See *id.* at art. 223 ([The arbitrator can be appointed, as an arbitrator in law or as an *amiable compositeur*] “El árbitro puede ser nombrado, o con la calidad de árbitro de derecho, o con la de árbitro arbitrador o *amigable componedor*”); Cód. Proc. Civ. art. 637 (LexisNexis, Chile 2005) ([An arbitrator acting as an *amiable compositeur* will listen to those interested, receive all instruments that are presented to him and add them to the arbitration, practice the proceedings that considers necessary for the knowledge of the facts and make the award with a sense of prudence

only follow the rules established by the parties in the arbitration agreement during the proceedings and when deciding the controversy.²²⁵

In Argentina, Chile, Colombia, Mexico and Venezuela, parties have the power to choose the language of the arbitration.²²⁶ In

and equity.] “El arbitrador oír a los interesados; recibirá y agregará al proceso los instrumentos que le presenten; practicará las diligencias que estime necesarias para el conocimiento de los hechos, y dará su fallo en el sentido que la prudencia y la equidad le dicten.”).

225. Cód. PROC. Civ. art. 636 (LexisNexis, Chile 2005) ([The arbitrator is not obligated to follow during the proceedings and in the award other rules than those established by the parties in the arbitration agreement. If the parties fail to do so, the subsequent provisions of this law will be applicable to the arbitration.] “El arbitrador no está obligado a guardar en sus procedimientos y en su fallo otras reglas que las que las partes hayan expresado en el acto constitutivo del compromiso. Si las partes nada han dicho a este respecto, se observarán las reglas establecidas en los artículos que siguen.”).

226. ALCA Cuestionario Argentina, *supra* note 217; Ley 19.971, art. 22, 9 de Octubre de 2004 (Chile) ([Parties can freely agree on the language or languages applicable during the arbitral proceedings. When there is no agreement between the parties regarding this matter, the arbitral tribunal will decide the language of the arbitration. This agreement or decision of the arbitral tribunal will be applicable to all of the documents of the parties, hearings, and any award, decision, or other type of communication announced by the arbitral tribunal, unless these instruments specify otherwise.] “Las partes podrán acordar libremente el idioma o los idiomas que hayan de utilizarse en las actuaciones arbitrales. A falta de tal acuerdo, el tribunal arbitral determinará el idioma o los idiomas que hayan de emplearse en las actuaciones. Este acuerdo o esta determinación será aplicable, salvo que en ellos mismos se haya especificado otra cosa, a todos los escritos de las partes, a todas las audiencias, y a cualquier laudo, decisión o comunicación de otra índole que emita el tribunal arbitral.”); *see* Ley 315, art. 2, 16 de Septiembre de 1996 (Colom.); Cód. Com. art. 1438 (Castrillón, Mex. 2002) ([Parties can freely agree on the language or languages of the arbitration. If they fail to do so, the arbitral tribunal will determine the language or languages of the arbitration proceedings. This decision or determination will be applicable, unless it is agreed otherwise, to all the documents of the parties, all hearings and any award, decision or other type of communication announced by the arbitral tribunal.] “Las partes podrán acordar libremente el idioma o los idiomas que hayan de utilizarse en las actuaciones arbitrales. A falta de tal acuerdo, el tribunal arbitral determinará el o los idiomas que hayan de emplearse en las actuaciones. Este acuerdo o esta determinación será aplicable, salvo pacto en contrario, a todos los escritos de las partes, a todas las audiencias y a cualquier laudo, decisión o comunicación de otra índole que emita el tribunal arbitral.”); Ley de Arbitraje Comercial, Ley No. 36.430, art. 10, G.O., 7 de Abril de 1998 (Venez.) ([Parties can freely agree on the language or languages applicable during the arbitral proceedings. When there is no agreement between the parties regarding this matter, the arbitral tribunal will decide the language of the arbitration. Unless they have determined otherwise, the decision of the arbitral tribunal will be applicable to all the documents of the parties, all hearings, and any award, decision or other type of communication announced by the arbitral tribunal.] “Las partes podrán acordar libremente el idioma o los idiomas que hayan de utilizarse en las actuaciones arbitrales. A falta de tal acuerdo, el tribunal arbitral determinará el idioma o los idiomas que hayan de emplearse. Este acuerdo será aplicable, salvo que ellos mismos hayan acordado otra

Argentina, Chile, Mexico and Venezuela, if parties fail to determine the applicable language to the arbitration, the arbitral tribunal will do it for them.²²⁷ Further, Brazilian arbitration law does not mention a specific language that should be applied in arbitration.²²⁸ In Chile, parties are able to determine the arbitration language, but if the award is going to be enforced in this country, it has to be in Spanish.²²⁹ In Colombia, parties can determine this aspect of the controversy according to international arbitration law.²³⁰

VII. COMPENDIUM OF CONCEPTS

To conclude this study, the following hypothetical case and its variations illustrate concepts covered in this paper.²³¹

Case: American Reinsurers v. Colombian Insurers S.A.

Facts: A Colombian insurer ("Colom-INS") purchases reinsurance from an American reinsurer ("American-RE-INS") for part of a primary policy with a Colombian bank ("Colom-BANK"). Specifically, the reinsurance is for:

1. Losses caused by assaults and robberies to Colom-BANK branches in small towns and rural areas of Colombia, and
2. Risks of losses caused by fraud of Colom-BANK employees.

At the time the reinsurance contract was signed, Colom-INS knew about, but did not inform American-RE-INS of possible on-going misbehavior and punitive conduct by some employees of Colom-BANK. Colom-INS also knew about, but did not reveal that there

forma, a todos los escritos de las partes, a todas las audiencias y al laudo, decisión o comunicación de otra índole que emita el tribunal arbitral.").

227. ALCA Cuestionario Argentina, *supra* note 217; *See also* Ley 19.971, art. 22, 9 de Octubre de 2004 (Chile); Cód. Com. art. 1438 (Castrillón, Mex. 2002); Ley de Arbitraje Comercial, Ley No. 36.430, art. 10, G.O., 7 de Abril de 1998 (Venez).

228. Area de Libre Comercio de las Américas (ALCA), *Grupo de Negociación sobre Solución de Controversias: Cuestionario Brasil*, http://www.ftaa-alca.org/busfac/comarb/Brasil/quesbra_s.asp (last visited Sept. 12, 2005); *see also* Lei No. 9.307, art. 13, 23 de Setembro de 1996 (Braz.).

229. *See* Ley 19.971, art. 35, 9 de Octubre de 2004 (Chile) ([If the award or the agreement are not drafted in the official language of Chile, the interested party should present a duly certified translation of the just mentioned documents in the official language of this country] "Si el laudo o el acuerdo no estuviera redactado en un idioma oficial de Chile, la parte deberá presentar una traducción debidamente certificada a ese idioma de dichos documentos.").

230. *See* Ley 315, art. 2, 16 de Septiembre de 1996 (Colom.).

231. The hypothetical example is based on some of the facts of *Brotherton v. Aseguradora Colseguros SA*, [2003] EWHC (Comm) 1741 (Eng.).

was an on-going investigation of fraud and disappearance of funds and that the national executive director and some employees under his supervision had already been arrested for those crimes. During pre-placement meetings, legal representatives of American-RE-INS asked Colom-INS about rumors of bad management at Colom-BANK. Colom-INS's response was that there were no concrete problems related to fraud or misconduct of Colom-BANK employees.

Colom-INS then experienced serious financial problems related to a recession in Colombia, and went into liquidation. By that time, however, Colom-INS had already received and accepted a claim from Colom-BANK for major losses due to continuous attacks and robberies by the guerrillas at branches around the country. Also, Colom-BANK claimed it lost substantial sums of money because of the proven fraudulent behavior of one of its executive directors and of some of its employees. The liquidator pursued a claim with American-RE-INS, but the reinsurer refused to pay, so the liquidator began arbitration proceedings.

The Reinsurance Contract

The reinsurance contract contained the following clauses:

Notification of Circumstances Clause: There will be no liability regarding any claim arising out of or in connection with any circumstances or incidents known to Colom-INS prior to the beginning of the contract hereof but not disclosed to American-RE-INS at the time of commencement.

Control Clause: Despite any contrary provision in this policy, the parties agree in this document that American-RE-INS will have the right to control claims. Therefore, Colom-INS must comply with the following conditions: (i) Colom-INS, after receiving a claim, will notify American-RE-INS of the claim during the following seven-work days from the date it became aware of the claim, and (ii) Colom-INS will submit all information regarding the risk or related events to American-RE-INS.

Insolvency Clause: American-RE-INS agrees to pay, in case of insolvency, reinsurance proceeds to Colom-INS, the reinsured, or to its liquidator. American-RE-INS will pay the reinsurance according to the liability derived from the reinsurance contract without any reductions due to the reinsured insolvency. Also, American-RE-INS and Colom-INS agree that the liquidator will notify American-RE-INS in writing about any pending claim against Colom-INS on the reinsured policies. Notification about pending claims will

be made in a reasonable period of time after the presentation of the claim to declare the insolvency of Colom-INS. While a claim is still pending and has not been accepted by Colom-INS, American-RE-INS can investigate the claim. Also, during the proceedings to accept or reject a claim, American-RE-INS can interpose all possible defenses it or Colom-INS may have. The expenses the American-RE-INS incurs defending Colom-INS will be charged to Colom-INS in proportion to the benefits Colom-INS obtains from the defense.

Governing Law Provision: The law of the United States is the substantive law that shall apply to this reinsurance agreement.

Arbitration Clause: Any controversy or claim arising out of or relating to this contract shall be determined by arbitration in accordance with the International Arbitration Rules of the American Arbitration Association. Any arbitration shall be before one arbitrator, and will take place in Miami.²³²

Claims

Colom-INS asserts American-RE-INS should cover Colom-BANK's claims because the reinsured risks occurred and were proven by the policyholder, Colom-BANK. Colom-INS also claims the insolvency clause requires payment directly to the liquidator, regardless of whether Colom-INS has paid the claims.

Defenses

American-RE-INS argues that it is entitled to void the reinsurance contract because Colom-INS violated the control clause which required Colom-INS to inform American-RE-INS of all circumstances likely to raise reinsurance claims. Specifically, American-RE-INS contends that at the time of the reinsurance contract, Colom-INS knew of the ongoing investigation of specific Colom-BANK employees by Colombian authorities, including even the names of those implicated, but remained silent regarding those material facts. American-RE-INS argues that Colom-INS's omissions induced them to assume the risk and violated the principle of good faith.

232. When selecting Miami as a forum for the arbitration, the parties took into consideration that the United States is signatory country to the Panama and New York Conventions, to increase the likelihood that the arbitration award will be enforced.

In fact, American-RE-INS contends that in response to its inquiries regarding rumors of mismanagement within Colom-BANK, Colom-INS made material misrepresentations by assuring American-RE-INS that Colom-BANK did not have such problems. American-RE-INS claims these misrepresentations induced American-RE-INS to enter into the reinsurance contract. American-RE-INS also argues that those misrepresentations violated the principle of good faith under Florida law and as implied in the reinsurance contract.

American-RE-INS argues that even if the entire contract is not voided, Colom-INS's prior knowledge of the risk related specifically to these claims violates the notification of circumstances clause which voids any reinsurance for these claims. American-RE-INS also asserts that the fact that the Colombian authorities' investigation is not finished does not save Colom-INS, because the information was material to the insurance and to the risk related to these claims.

Arbitrator's Analysis

Under the stated circumstances, an arbitrator may have the following considerations:

1. Although the insolvency clause is valid and legal under United States laws, it cannot be enforced in this case because Colom-INS's lack of good faith makes the reinsurance contract void.
2. The reinsurance contract is not enforceable because Colom-INS's misrepresentations were material enough to have affected American-RE-INS's decision to enter into the reinsurance contract or to the premium charged. Also, the non-disclosure of those material facts induced American reinsurers to reinsure the risk, because if American-RE-INS had known money was lost, an investigation by Colombian authorities was ongoing, and some Colom-BANK employees had been arrested for these crimes, American-RE-INS would never have issued the reinsurance.
3. Colom-INS was required to reveal all relevant facts that may be material to the risk in accordance to the principle of good faith under United States law. Also, the misrepresentations violated the duty of good faith in Colombian law, and the false or inaccurate declarations of the risk ("reticencia") required rescission of the contract.

A Variation (of Some of the Facts)

In this variation, the facts are the same, except:

1. Colom-INS discloses all the relevant and material facts related to the risk to American-RE-INS;
2. There is no arbitration clause in the reinsurance contract;
3. The contract negotiations and pre-placement meetings took place in Miami, Florida;
4. The parties did not choose a governing law for the reinsurance contract, although they selected Miami as the forum to decide any controversy arising under the contract; and

5. The reinsurance contract has a cut-through clause rather than an insolvency clause, which states:

Cut-through Clause: Regarding the responsibility assumed in the insurance policy, American-RE-INS agrees to pay the assured sum directly to Colom-BANK according to the provisions of the reinsurance contract. American-RE-INS will pay reinsurance proceeds to Colom-BANK, if Colom-INS is experiencing economic problems and it is impossible for Colom-INS to pay the claim. American-RE-INS is obligated to pay when Colom-INS has accepted the claim or payment of the claim has been required by a judicial decision.

Claims

Colom-BANK sues American-RE-INS in Miami, claiming that the cut-through clause gives it a right of direct action against American-RE-INS. Colom-BANK claims that the insured risk took place and Colom-INS is unable to pay the indemnity because it is in liquidation.

Defenses

American-RE-INS files a motion to dismiss on the ground of *forum non conveniens*. American-RE-INS wants to have the case decided in Colombia because under Colombian law, cut-through clauses are invalid and unenforceable, although there is some possibility a Colombian court may consider this cut-through clause valid because it protects and benefits the original policyholder, and a Colombian judge may find the parties intended the cut-through clause to apply to the reinsurance.

Possible Considerations by a Judge

The judge may not dismiss the case on grounds of *forum non-conveniens* and decline to enforce a forum selection clause for the following reasons:

1. There is easy access to sources of proof in Miami, where the reinsurance contract was signed, and relevant documents and witnesses regarding the reinsurance contract are located in the United States;
2. The contract is written in English;
3. There is no need to apply foreign law because American-RE-INS is located in Florida, the contract was signed in Florida, and under Florida law, cut-through clauses are enforceable;²³³ and
4. The chosen forum is not seriously inconvenient for the trial of the action in U.S. Each party will not be deprived of having its own day in court.²³⁴

VIII. CONCLUSION

As Latin American countries globalize, reinsurance represents a beneficial and even essential mechanism to support the required economic development. Accordingly, most Latin American countries have tried to regulate reinsurance in a general way

233. FLA. STAT. § 631.205 (2005) (“[A]ll reinsurance proceeds payable under a contract of reinsurance to which the insolvent insurer is a party are to be paid directly to the domiciliary receiver as general assets of the receivership estate, unless the reinsurance contract contains a clause which specifically names the insolvent insurer’s insured as a direct beneficiary of the reinsurance contract.”).

234. See generally R. Doak Bishop and David B. Lee, *Enforceability of Forum-Selection Clauses in International Commercial Contracts*, CURRENTS: INT’L TRADE L.J., Fall 1995, at 28, 28-31 (citing *Bremen v. Zapata Off-shore Co.*, 407 U.S. 1, 15-18 (1972)). In this case, also known as “*The Bremen*,” Chief Justice Burger delivered the opinion of the Court with respect to the enforcement of a forum-selection clause that provided for treatment of any litigation before the London Court of Justice in an international towage contract. The parties to the contract were an American company (Zapata) and a German corporation (Bremen). The American company sought to set aside the forum-selection clause. Burger held that the forum-selection clause was *prima facie* valid and was to be honored by the parties and enforced by the courts in the absence of some compelling and countervailing reason making enforcement unreasonable. Some of the factors that may be considered in determining the reasonableness of a forum-selection clause include: fairness of the selected forum, the selected forum’s domestic situation, the relation of the selected forum to the transaction, choice of law issues, and the availability of witnesses and discovery. The Court also determined that forum-selection clauses will be given full effect unless the clause is affected by fraud, undue influence or overwhelming bargaining power. Finally, the Court specified that a contractual choice of forum clause should be held unenforceable if its enforcement would be contrary to the public policy of the forum where the suit is filed.

to permit reinsurers to market their services on terms that are fair for them, for domestic insurers and for consumers. Yet, there are important distinctions in how Latin American countries have independently integrated concepts of reinsurance law into their own civil code systems. Understanding these distinctions is absolutely necessary to understand reinsurance and development across Latin America.

As reflected in this comment, the individualistic approach taken in Latin American countries results in distinctions in treatment of even the most commonly-held reinsurance doctrines of utmost good faith and follow-the-fortunes. Furthermore, specific contract clauses; such as control clauses, simultaneous payment clauses, insolvency clauses, and others, have been developed internationally with the intent of modifying the traditional reinsurance relationship or specifically addressing a particular issue. The impact of such provisions in Latin American countries has varied. Similarly, although a direct action by a policyholder against a reinsurer is generally not permitted by legal codes in Latin American countries, courts in Latin American countries have not rejected this possibility with the same strength or vigor as in other markets and there are some principles that make the risk of a direct action more real in certain countries.

As also examined here, the normal preference for arbitration to resolve reinsurance disputes is even greater in Latin American countries, because of concerns about alternative dispute forums and, in many ways, because of the distinctions in the way courts in Latin American countries may resolve reinsurance disputes. Together, the observations and analyses here have been intended to both provide a starting point for understanding the complexities of reinsurance in Latin American countries as their economies globalize and lead the path to dispute resolution.