INTRODUCTION

This paper examines the surprising persistence of informal economic exchange in the reinsurance industry. Remarkably in light of their risk level, stakes, and complexity, reinsurance contracts were for most of their history concluded very informally, including by handshake, scribbles on a napkin, or a “slip” of a couple of pages. This form of contracting continued in substantial part into the 1980s, with contract documents leaving key terms “to be agreed” or entirely unspecified. The industry historically governed itself under an “utmost good faith” norm for business relationships, and disputes were arbitrated by industry experts under this remarkably general standard. Today, reinsurance contracts are often recorded in documents of over 100 pages. However, even today’s lengthy reinsurance contracts retain traces of the old informality: they leave

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3 MUNICH RE, REINSURANCE CONTRACTS 4 (2016).
key terms undefined to an extent that is atypical in sophisticated commercial contracts and set out less rigorous accounting requirements between contracting parties.\(^4\)

This paper will describe the network structures, the social and business practices, and the economic characteristics of the business that allowed the reinsurance industry to maintain such informality in contracting for such a long time, including as insured risks grew more valuable and complex over the Twentieth Century. Either this paper or a later one will examine why reinsurance contracting moved so quickly near the end of that century toward formality after such a lengthy stretch of informality. The paper builds on previous case studies of persistent pockets of cooperation without, or with limited, reliance on legal institutions. In his book *Stateless Commerce*, Barak Richman argues that certain segments of the modern economy retain stateless, trust-based forms of organization because idiosyncratic market features and social structures give those trust-based forms of exchange advantages over other ways of governing market behavior. Richman concludes with an “autopsy of cooperation” that chronicles the decline of private ordering in the diamond industry. In his classic work *Order Without Law*, Robert Ellickson seeks to explain “in what social contexts and with what content informal norms emerge to help people achieve order without law.” This study of the reinsurance industry seeks to build on that earlier work to shed more light on the conditions necessary to maintain informal cooperation and when informal exchange is economically efficient. It will argue that the answers to those questions should inform how courts interpret contracts.

I. FROM INFORMAL EXCHANGE TO FORMAL CONTRACT

In his classic article on “non-contractual relations in business,” Stewart Macaulay described contractual relationships as involving “rational planning of the transaction with careful provision for as many future contingencies as can be foreseen” and “the existence or

\(^4\) MUNICH RE, REINSURANCE CONTRACTS 7 (2016).
use of actual or potential legal sanctions to induce performance of the exchange or to compensate for non-performance.” Macaulay observed that whether a relationship is contractual is not a binary question. Economic exchange relationships can vary in their “contractualness” in two respects: how thoroughly the parties specify rules for future contingencies and the formality of the provisions they make for resolving disputes that arise in the relationship.5

A body of scholarly case studies has described how social interdependence among ethnic and religious groups and in geographically centralized, close-knit communities allows those communities to support robust trade without conventional contract law institutions. More recent scholarship has identified how groups of economic actors combine some elements of formal contract with non-contractual mechanisms to support economic relationships. Those case studies can be visualized within Macaulay’s framework of the contractual quality of economic relationships as follows:

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Figure 1
Formal Dispute Resolution

- Agreements for collaborative innovation
- "Scaffolded" contacts in innovative sectors
- Standard form contracts
- Bond indemnities
- Reinsurance contracting today
- 1860s through 1990s
- "Brading" contacts
- Diamond merchants
- Hokkien-Chinese middlemen
- Highly informal exchange


The concept of formality of dispute resolution might be further subdivided into the coerciveness of enforcement and the degree of discretion granted to a third-party adjudicator. Under that rubric, the least contractual form of dispute resolution would be informal negotiations between the parties as unforeseen contingencies arise, in which each is permitted to exit the relationship at any time. The most contractual form of dispute resolution would submit disputes arising out of the relationship to an adjudicator with coercive enforcement power for determinations of rights and duties as extensively described a written contract.14

14 There is some conceptual muddiness about what constitutes formalism in dispute resolution. First, how is the degree of discretion granted to an adjudicator to be categorized along a spectrum of formality? In the contract theory literature, the term “formalism” describes approaches to interpreting contracts that hew closely to the parties’ textual expression of their agreement. On this view, formalist contract adjudication means adjudication by a highly constrained adjudicator whose authority is limited to discerning what the parties intended, as manifest in the text of their agreement. Such formalist approaches to adjudication are contrasted with contextualist adjudication that seeks to ascertain the parties’ intention ex post by examining the parties’ negotiations, course of dealing, course of performance, and the broader context, including trade usages and customs. If contracting parties empower an adjudicator to decide their disputes based on equitable or other broad principles but her determination of the parties’ entitlements is backed by strong coercive enforcement power, this situation does not seem to fit neatly within the category of “informal” dispute resolution. It might be best to see this aspect of formalism in dispute resolution as pertaining to the other variable of how specified the parties’ obligations are.

A second complication is that a dispute resolution process might be formal in the sense that it is governed by highly specified or even juridified procedural rules and provides for a determination of rights and obligations by a third-party decision-maker, while at the same time failing to provide a strong coercive enforcement mechanism. An example is non-binding arbitration. Another is sovereign debt, as one of us argues in an earlier paper. Sadie Blanchard, Courts as Information Intermediaries: A Case Study of Sovereign Debt Disputes, BYU L. REV. (forthcoming 2019).

The two dimensions along which dispute resolution might be described as formal makes it difficult to ordinally rank the formality of processes that differ across the two dimensions. For example, is adjudication by a public court (presumably with strong coercive power) that the contracting parties direct to apply modern contextualist contract interpretive methods more or less formal than
Comparative institutional advantage explains at least in part why certain segments of the modern economy retain old, stateless forms of organization that eschew state-backed legal mechanisms for governing exchange relationships in favor of mechanisms such as private dispute resolution and reputational sanctions.\textsuperscript{15} Richman's study of the diamond industry explains how that industry was able to retain premodern modes of organization in the face of widespread economic modernization and why the industry eventually modernized. In the diamond industry, the traditional modes of exchange eventually became inefficient due to changes in production methods, competitiveness, and marketing techniques. Richman describes an "institutional life cycle" of cooperation in which informal exchange networks "sow the seeds of their own demise."\textsuperscript{16} In Richman's account, the industry's success attracts new entrants, which breaks down informal mechanisms for credible commitments. The isolated community that formed the exchange network becomes mainstreamed and now has more choices and opportunities that reduce members' cost of cheating one another. Cheating by marginal players initiates a vicious cycle that increasingly erodes trust.\textsuperscript{17} In the diamond industry, the traditional order was replaced in part by vertical integration.\textsuperscript{18}

For 150 years, from the industry's inception to the late 20th Century, reinsurance contracts fell somewhere in the bottom left quadrant of Figure 1. Written agreements, where they existed, were perfunctory, often scribbled on scrap paper, and contained few terms. When disputes arose, they were adjudicated by private arbitrators drawn from the reinsurance sector who were empowered by the typical arbitration clause in reinsurance contracts to consider

\textsuperscript{15} BARAK RICHMAN, STATELESS COMMERCE, xii–xiii (2017).
\textsuperscript{16} BARAK RICHMAN, STATELESS COMMERCE, __ (2017) (citing Avner Greif 2006 at 175).
\textsuperscript{17} BARAK RICHMAN, STATELESS COMMERCE, __ (2017).
\textsuperscript{18} Id. at __.
the contract as an "honorable engagement" or "gentlemen's agreement" rather than a strict legal obligation and to determine the outcome by inferring, on the basis of industry custom, what outcome the parties must have intended. For example, one standard clause from the 1970s provided, "The Arbitrators are relieved from all judicial formalities and may abstain from following strict rules of law."\(^{19}\) Formal judicial enforcement of arbitration awards was rarely pursued.\(^{20}\) The extent to which such enforcement was available for much of that period is unclear. Even after the United States and other legal systems made arbitration awards reliably judicially enforceable around the middle of the Twentieth Century,\(^{21}\) it is not clear to what extent reinsurance arbitration awards were enforceable, given that the accounts of them in industry literature suggest that they often lacked requisite formalities for the enforcement of arbitration awards, including a written arbitration agreement and an arbitral award stating reasons for the arbitrators' decision.\(^{22}\) Moreover, industry

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\(^{20}\) Richman points out that much of the literature on private ordering conflates private ordering in the shadow of the law and truly "stateless" or extra-legal commerce. Just because contracting parties do not litigate does not mean that their knowledge of the availability of the law to enforce their contract does not shape the way they interact with one another. Richman, *Stateless Commerce*, at 5 (citing Mark Galanter’s point that the “principal contribution of courts to dispute resolution is providing a background of norms and procedures against which negotiations ... take place”). However, the features of reinsurance suggest that it might very well have belonged for most of its history in the category of what Richman calls "stateless commerce," at least until the middle of the Twentieth Century. The contracts might have been too indefinite to be enforceable by courts, and they were very often international contracts during a time when the hurdles to enforcing such contracts were very high. See Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641 (2003) (showing that the indefiniteness doctrine remains robust and that many indefinite contracts are deliberately so).


\(^{22}\) Reasons are required for an enforceable award in some but not all jurisdictions. See Gary Born, *International Commercial Arbitration* 3039-40 (2d ed.
requirements of confidentiality would have acted as a high barrier to publicizing disputes by pursuing judicial enforcement of arbitration awards.\textsuperscript{23} Finally, an account by an industry insider written as late as 1977 states that reinsurers were even loath to take their disputes with clients to arbitration (not to mention litigation), and that arbitrations were still rare.\textsuperscript{24}

How was the reinsurance industry able to maintain highly informal exchange relationships well into the 20\textsuperscript{th} Century? And why did exchange relationships dramatically and rapidly increase in formality, both in the level of specificity of obligations and in the degree of formality of dispute resolution? Richman’s account of the diamond industry highlights how surprising it is that the reinsurance industry was able to sustain informal exchange for so long. The industry did not rest on a homogeneous, socially cohesive group and was not geographically concentrated. However, there are facts in the industry’s history that suggest that certain social and business practices might have been adopted to cultivate trust. An open question is whether and how the industry employed legal forms and institutions to buttress informal modes of transacting.

II. INFORMALITY AND FORMALITY IN REINSURANCE

Reinsurance contracting has long been informal. The industry primarily relies on private arbitration by industry experts to resolve disputes.\textsuperscript{25} As late as the 1990s, contracts were frequently written in a “slip” document of a few pages, leaving terms listed as “to be agreed” or entirely unspecified. This practice was driven by either the custom of concluding most reinsurance contracts during a brief period or two each year, or by the repeat-player dynamic among


\textsuperscript{24} See Crittenden at 234 (1977).

\textsuperscript{25} MUNICH RE, REINSURANCE CONTRACTS 4 (2016).
reinsurance companies, brokers, and ceding companies, or both.\textsuperscript{26} To accomplish the speedy conclusion of many contracts, companies "leveraged their utmost good faith relationship by binding the essential economic terms" upfront and adding others terms later or never, sometimes leaving terms unspecified after a course of dealing of over a century.\textsuperscript{27} The rapid change in formality of contracting in reinsurance highlights how unusual it was that the industry retained such a degree of informality for so long.

In a relatively brief period approaching the year 2000, reinsurance contracts got much longer. It is now not unusual for contracts to be between 100 and 200 pages long. This dramatic change in contract form might be expected to be accompanied by other changes in recourse to legal institutions suggesting a breakdown in trust or informality of relationship management, such as increased litigation. However, while the incidence of litigation has increased in absolute terms (number of cases), it has not increased relative to the size of the market.\textsuperscript{28}

Even today, reinsurance dispute resolution retains some elements of informality. Most adjudicated reinsurance disputes are decided by arbitrators. Reinsurance arbitration is typically not conducted under

\textsuperscript{26} MUNICH RE, REINSURANCE CONTRACTS 7 (2016).

\textsuperscript{27} MUNICH RE, REINSURANCE CONTRACTS 5 (2016); Edwin W. Kopf, Notes on the Origin and Development of Reinsurance 38 (describing the first reinsurance contract on the record in England, concluded in 1824 and still in effect as of the writing in 1929, and for which "no formal treaty was prepared, the binding arrangements being conducted through correspondence with the good faith of both parties pledged.").

\textsuperscript{28} A case count was conducted by searching for decisions including the word "reinsurance" in all U.S. courts on Lexis Advance and refining the results using the terms "reinsurer or retrocessionaire or cedent or reinsured" to target cases between primary insurers and reinsurers. The facts or the overview of each case were then reviewed to make sure that they were cases between insurers and reinsurers. Data on market size over time are being hand-collected from print trade publications. Preliminary results show that during the period from 1980 to 2000, both the number of new (previously uncounted) lawsuits and the value of premiums written increased three-fold. See Appendix 1.
an established arbitral institution such as the International Chamber of Commerce Court of Arbitration or under widely used commercial arbitration rules. The parties and the arbitrator set rules ad hoc for each arbitration. However, the increase in the number of disputes has led to increased formalization of reinsurance arbitration. Reinsurance arbitrators are professionalizing. The AIDA Reinsurance and Insurance Arbitration Society has codified traditional arbitration procedures into rules called the “Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes,” though adoption of those rules in reinsurance contracts has been slow.²⁹ Importantly, since arbitration awards are now judicially enforceable under the Federal Arbitration Act in the United States and the New York Convention on the Recognition and Enforcement of Arbitration Awards transnationally, arbitration is significantly more formal than it was in the days when arbitral awards were not reliably enforceable by courts. In contracts between parties from different countries, an arbitration award will often be easier to enforce than a court judgment.

A. Reinsurance Contracting Historically

The industry was international from its inception.³⁰ The first “independent professional reinsurance company was Cologne Re,”³¹ which wrote its first treaties in 1852 after the Great Fire of Hamburg.³² In the U.S., reinsurance developed initially as one type of underwriting carried out by primary insurers, and specialized


³⁰ However, Lisa Bernstein shows in a recent paper that network-based informal economic exchange can be conducted over very long distances if there are strong ties between important nodes in densely connected networks in each location. See Lisa Bernstein, Contract Governance in Small World Networks: The Case of the Maghribi Traders, NW. U. L. REV. (forthcoming 2019).


reinsurance firms developed by the early 20th Century. Specialized reinsurance firms had a competitive advantage over general insurers underwriting reinsurance because of the gains from specialization and their ability to alleviate the fear of insurers that taking reinsurance would make known their private business information to competitors in the primary insurance business who were also offering reinsurance.

The specialist reinsurance industry developed primarily in Switzerland (with Swiss Re) and Germany. Munich Re, one of the early specialized reinsurers, was formed with an explicit early goal of engaging in transnational business; before 1900, it had offices in Paris, Russia, London, and New York. The modern reinsurance market arose with the industrial revolution, with fire reinsurance being the most common variety. Reinsurance was an early industry to globalize because of the recognition of the value of spreading risk widely, which international business served. Munich Re was founded with an explicit goal of operating across borders, the justification being the smoothing of local business and weather conditions. After a tumultuous start, Swiss Re decided to focus on wider geographic spread of its risk; a key part of this strategy was to resist entering into contracts that required it to accept a block of risk tied to particular regions or countries. By the 1860s, Swiss Re

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33 Holland at 21.
35 Holland at 19.
37 Kopf 32.
38 Kopf at 32.
insured risks in 20,000 locations.\textsuperscript{40} The volume of cross-border business was so substantial that an important study of the industry published in 1929 identified “What has been and what is the place of reinsurance in international private law?” as an important question for study by the Casualty Actuary Society.\textsuperscript{41}

From the mid-19th Century, trust and the reputations of transaction partners were a key concern.\textsuperscript{42} The first specialist reinsurance firms faced difficulties that to modern eyes are unsurprising: primary insurers reinsured their worst risks.\textsuperscript{43} Perhaps more surprising is that reinsurers paid high prices to secure new business.\textsuperscript{44} [What does this mean?]. Firms sought third-party information about others' reputation and business practices from this time.\textsuperscript{45} Best's Reports, a rating service for insurance companies, was founded in 1899.\textsuperscript{46}

Given these facts about the history of the industry, accounts of how informally parties transacted are surprising. There are no obvious social structures that were acting as substitutes for formal legal structures to incentivize parties to fulfill their contractual obligations or even to deter fraud. So far, we have identified in the historical literature some leads as to structures that the industry might have used to sustain trade.

It is possible that even though the industry was globally dispersed, it consisted of a small, close-knit group or owners that had multiple ties. One sign of multiple ties might be owners' board membership on different companies together, or cross-board

\textsuperscript{40} Pearson at 43.
\textsuperscript{41} Kopf at 75.
\textsuperscript{43} Swiss Re, \textit{A History of Insurance} 23 (2017).
\textsuperscript{44} Swiss Re, \textit{A History of Insurance} 23 (2017).
\textsuperscript{46} Pearson at 46.
appointments. It might be significant that one of the early German independent reinsurers in the early 20th century thought it beneficial to attain a substantial or controlling stock interest in direct insurance companies.\footnote{Kopf at 32.} Consider also the founding of Swiss Re. Allgemeine VG Helvetia, a transport insurance company, established a specialist reinsurance office as a new venture together with a major Zurich bank (Schweizerische Credit Anstalt), Basler Handelsbank, and Swiss Lloyd Transport Insurance Office.\footnote{Pearson at 31.} The board comprised eminent figures from Swiss finance and insurance.\footnote{Pearson at 31.} One historical account emphasizes the social ties, “close-knit, personal relations,” among the financial elite running insurers and reinsurers during the 19th Century: “it was … recognized that to construct trust among partners in this specialist and, to the public, largely invisible, financial service was among the most important tasks of an international reinsurance manager in a world of increasingly complex and diverse risks.”\footnote{Pearson at 46-47.} In England, for a substantial period, reinsurance providers were viewed by the larger finance and even insurance industries as a socially inferior group, so there was not much crossover from other forms of insurance into the reinsurance business.\footnote{[Find the citation.]} That might be significant if it resulted in players in the reinsurance having few outside options.

Also noteworthy, however, is that the industry did not form an association until 1969.\footnote{Julius A.S. Neave, *The Changed Face of Reinsurance*, THE GENEVA PAPERS ON RISK AND REINSURANCE, vol. 8, no. 28, p. 185, 188 (1983).} This appears to be a departure from the typical profile of industries in the literature that rely on informal exchange and private dispute resolution. Usually where the industry was not composed of members of a discrete and insular minority, or a geographically concentrated group, trust was built by trade associations and similar institutions.

One possible solution to low trust and the absence of
mechanisms that enable parties to make credible commitments is to align contracting parties' incentives. Munich Re began to do this early on, developing a strategy of sharing their success with ceding companies by adjusting prices in future transactions based on claims paid in the past.\textsuperscript{53}

We hope to learn through further research the extent to which each of these, and other, features of the industry contributed to the maintenance of trade in the absence of strong legal enforcement mechanisms.

B. The Recent Evolution of Reinsurance Contracting

There are several plausible hypotheses about why informal business relations in reinsurance broke down. They are not all mutually exclusive. One hypothesis is that the network structure of the industry changed as new entrants began offering reinsurance. However, we wonder whether a real understanding of why parties moved to contract, and of what that implies for contract law, requires understanding why the network structure changed.

The 1970s were eventful for the reinsurance industry. In 1973s, a massive fraud was committed on reinsurers. A primary insurer fraudulently created new direct insurance policies and took out reinsurance on them to earn commissions and collect benefits.\textsuperscript{54} Also during the 1970s, innovations in actuarial methods that allowed for better risk pricing revolutionized the primary insurance market, especially in life insurance, increasing competition and consequently the demand for reinsurance.\textsuperscript{55} New possibilities for devising more accurate pricing and risk distribution techniques shifted the industry from a state closer to commoditization to a state closer to that of a

\textsuperscript{53} Swiss Re, History of Insurance 23 (2017).
\textsuperscript{55} Holland at 25.
young industry. The employment of new actuarial techniques was relatively risky, perhaps increasing the demand for reinsurance relative to the value of primary insurance policies outstanding.

The 1990s were characterized by consolidation and the founding of new life reinsurers in offshore locations such as Bermuda. Several of the largest direct insurance companies went out of business, especially life insurance businesses. During this decade, life reinsurance became more competitive because of innovations including regarding pricing in the preferred underwriting classification, the category of lower-risk individuals that are charged lower premia.\textsuperscript{56}

Today, reinsurance contracts take at least two different forms. Arms-length, formal contracts are becoming more common, while informal contracts between parties that have a long course of dealing are becoming less common.\textsuperscript{57} These contracts are now commonly recorded in documents of over 100 pages.\textsuperscript{58} However, they retain some aspects of informality relative to other industries' commercial contracts, which reflects the remnants of the industry's historical "utmost good faith" norm for business relationships. For instance, they leave key terms undefined and are less rigorous in accounting between parties; for instance, they use fewer reporting forms.\textsuperscript{59} An arbitration provision from a 1985 Munich Re contract illustrates the persistence of the utmost good faith standard:

In the event of any difference hereafter arising between the contracting parties with reference to any transaction under this treaty the same shall be referred to two Arbitrators who are to be chosen amongst the Managers or Secretaries of Accident Insurance Companies,

\textsuperscript{56} Holland at 27.
\textsuperscript{57} MUNICH RE, REINSURANCE CONTRACTS 2 (2016).
\textsuperscript{58} MUNICH RE, REINSURANCE CONTRACTS 4 (2016).
\textsuperscript{59} MUNICH RE, REINSURANCE CONTRACTS 7 (2016).
one to be chosen by each Company and to an
Umpire chosen by the said two Arbitrators,
who shall interpret the present contract rather
as an honourable engagement than as a merely
legal obligation, and their award shall be final
and binding on both parties.  

In 1994, the National Association of Insurance Commissioners,
a body of state insurance regulators, amended its accounting
practices guidelines to state that a reinsurance contract had to be
finalized and recorded in writing within nine months or it must be
accounted for as a retroactive financial transaction. The
consequence of this rule was that if a reinsurance contract was not
recorded within the specified time period, the "reinsurance could not
be used to reduce a ceding company's loss reserves," which
measure an insurer's liability for future claims. A reduction in loss
reserves represents an apparent increase in the insurer's risk level.
Industry observers at the time of the change noted that it would
burden companies for which reinsurance contracts were a low
priority and those that had limited legal staff or technology to devote
to careful and timely contracting.

The destruction of the World Trade Center in New York on
September 11, 2001 might offer some indications of why greater
contract certainty was sought beginning in the 1990s. Calls for
contract certainty increased after the attacks because the World
Trade Center had been insured under contracts in which important
terms were left unspecified. Observers believed that more specific
contracts would have permitted the disputes involving insurance

60 See Michael S. Olsan, Altering the Structure of Reinsurance Arbitrations: Are
April 9, 1997.
coverage of the World Trade Center to be resolved more quickly.\textsuperscript{64} This would have ostensibly permitted speedier rebuilding, which would have reduced the externalized costs from delay in restoring the site.

The World Trade Center insurance disputes provoked regulatory action in the United States, the UK, and Bermuda to require contractual certainty, that is, the execution of highly specified, formal, written documents before reinsurance contracts would be effective.\textsuperscript{65} Therefore, within a decade, the industry shifted from a practice of minimal to no written contract to one of highly formal, lengthy writings.\textsuperscript{66}

In the mid-2000s, the reinsurance brokers and underwriters trade group in London implemented a Contract Certainty Code of Practice, requiring that contracts be final and certain on their date of inception.\textsuperscript{67} As in the United States, this change was prompted by government regulators.\textsuperscript{68} A commentator suggests that the reasoning behind the push for contract certainty is to permit correct pricing and reduce disputes. But why was it believed that the parties were unable to do this themselves? Was there a view that they underappreciated the costs of later disputes? Did regulators fail to appreciate the costs of formal contracting or overestimate the costs of disputes? The story that regulators caused the move to formal contract is, however, probably too simple.

\section*{III. Why It Matters}

\textsuperscript{65} Munich Re, Reinsurance Contracts 5 (2016).
\textsuperscript{66} Munich Re, Reinsurance Contracts 5 (2016).
\textsuperscript{68} https://www.londonmarketgroup.co.uk/contract-certainty.
Legal scholars should care about when and why economic actors order their exchange relationships through contract versus through other mechanisms.

First, theory suggests that certain kinds of transactions are more efficiently organized by informal mechanisms rather than formal contract. When deciding how textually or contextually to interpret contracts, courts should look at factors that shape the contract's design. Contracting parties might intentionally adopt agreements that are too vaguely worded to be enforceable by courts because they prefer to rely on informal sanctions based on reciprocity in long-term exchange relationships or on reputation to incentivize the parties to fulfill their obligations. They might to do so because the desired level of performance is not fully verifiable to courts, and the prospect of courts' mistaken assessments of of the parties' performance incentivizes opportunism whereby one party might underperform and then misrepresent its level of performance to a court and win damages. If courts adopt broad contextualist interpretive methodologies that impose formal judicial remedies for breach on parties that ex ante wished for their contracts to be only informally "enforced," they will cause parties to adopt inefficient forms of contracting. It might be the case, then, that formal legal structures invade and crowd out informality in instances where informal exchange is more efficient.

Bernstein describes economic sectors governed by highly specified obligations enforced by industry arbitration in which the arbitrators employ a highly formalist approach to contract interpretation. Traders in such sectors prefer formalist interpretation because, among other reasons, it leaves room for the parties to informally accommodate one another as exigencies arise without thereby finding themselves bound to do so in the future because a

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69 Gilson, Sabel & Scott, Text and Context, 100 CORNELL L. REV. 23, 23 (2014).
71 Id. at __.
contextualist adjudicator infers that the parties' course of dealing implies a change in their contract terms. Charny argues that trade association arbitration is distinctive and operates under a set of economic features not shared by most groups of commercial transactors. Therefore, finding formalism as the dominant approach to contract interpretation in private adjudication does not tell us how courts ought to interpret commercial contracts generally.

In reinsurance, private dispute resolution is highly informal. It does not look like the highly specified, rule-bound arbitration that Bernstein finds in the cotton industry and similar sectors. Instead, expert industry members are directed to infer the parties' intentions from custom and not to be bound by law. Generalizing Charny's argument, we might say that courts should not infer from the way contracting parties direct arbitrators to decide their disputes that they would want courts to decide their disputes in the same way.

The crowding out concern is present in reinsurance because the history of its move toward formalization includes significant pressure to move in that direction from regulators. An interview subject explained that in the 1990s, losses were growing, and people began to question the practice of handshake and slip contracts. During that time, the National Association of Insurance Commissioners adopted an accounting rule requiring that reinsurance contracts be reduced to writing within nine months of inception. After the September 11 attack on the World Trade Center, regulators in the United Kingdom warned the industry that if it did not begin to write more specific contracts voluntarily, formality would be imposed by regulation. Regulators in New York made similar threats with less apparent seriousness, but industry players still consider the prospect of enforced contract specificity a real one

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74 Interview with Partner in large law firm with decades of experience in insurance and reinsurance dispute resolution, March 12, 2018.
if the industry does not voluntarily move in that direction.\textsuperscript{75}

On the other hand, it is remarkable that industry players continued to use handshake and slip contracts into the 1990s, when, as the interview subject explained, "it was no longer an old boy's network."\textsuperscript{76} If the traditional network structure and economic conditions had already substantially changed, as evidenced by the larger number of players and the increased incidence of litigated disputes, what sustained the trust that enabled people to continue doing business this way? It is possible that path-dependence combined with agency problems undermined incentives for industry players to adapt their practices in response to changing economic circumstances. An interview subject suggested that this was the case. When asked why regulators felt the need to push the industry to embrace more definite contracts if the business necessity to do so was already there, he answered,

This is a tradition-based industry, and there was inertia. Insurance company agents had always been buddies with the people they were ceding policies to; they would make deals after the fact about how to distribute losses among themselves under reinsurance treaties. Once losses from asbestos and other environmental torts became monumental, they couldn't operate this way anymore. Before, lawyers were not involved in reinsurance drafting. The parties didn't care about the wording because they would work it out between themselves later.

He suggested that even the rise of insolvencies was not causing

\textsuperscript{75} Interview with Senior executive at a major reinsurance company. April 13, 2018.

\textsuperscript{76} Interview with LS, March 12, 2018.
reinsurance companies to quickly adapt their practices.\textsuperscript{77}

Moreover, a recent publication by Munich Re, one of the largest providers of reinsurance, states that "[r]einsurance contract wording does not reflect current business relationships."\textsuperscript{78} The report describes the current state of contracting as problematically straddling the old, informal modes of doing business and formal contract. Although contracts have lengthened, they remain shorter than commercial contracts of similar value in other industries, fail to define terms, and require detailed reporting between the parties.\textsuperscript{79}

Understanding why an industry that functioned for over a century using informal exchange rapidly adopted formal contract is a step toward understanding whether the change serves or undermines efficient contracting. It might improve our understanding of how legal rules and institutional structures threaten socially valuable economic relationships and how they strengthen them. Finally, better understanding the reasons for movement along the plane of contractualness might help courts and other adjudicators to better construe the contracts that come before them, and legal policymakers to design more efficient legal rules.

IV. Questions

This project is at a fork in the road, and we would be grateful for suggestions about where to go next. The two decisions are whether to dive into theory or empirics, and whether to focus on the old form of contracting or the change in contracting. We have a basic understanding of the industry and hypotheses about (at least some of) the mechanisms used to support informal contracting and some of the reasons those mechanisms stopped working. We could continue to focus on empirics, pursuing a better understanding of

\textsuperscript{77} Interview with Partner in large law firm with decades of experience in insurance and reinsurance dispute resolution, March 12, 2018.

\textsuperscript{78} MUNICH RE, REINSURANCE CONTRACTS 7 (2016).

\textsuperscript{79} MUNICH RE, REINSURANCE CONTRACTS 7 (2016).
the history of the industry. That would require more historical research in secondary sources and probably also primary sources, including corporate archives and interviews. Alternatively, we could go further into the economics literature on relational and reputational contracting search of theories that might direct our empirical research.

One idea that we have begun to pursue is to analyze cases to determine whether it is true that the increase in unpredictable risk from mass-tort litigation was a key driver of the breakdown of relational contracting. This seems to be received wisdom among industry participants. A preliminary analysis of the reinsurance cases decided between 1977 and 1984 does not indicate that mass tort litigation dominated reinsurance litigation during this time. However, it could be that most reinsurance litigations based on mass tort claims were settled. It might also be that it took longer for those disputes to arise in reinsurance, but that their presence on the horizon caused parties to realize they needed to change their contracting practices. We might find more mass tort-based reinsurance litigation in later years. It might also be that a small number of high stakes disputes was enough to motivate widespread change in contracting practices.

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80 See, e.g., Larry Schiff (find cite); Michael S. Olsan, Altering the Structure of Reinsurance Arbitrations: Are Old Habits Too Hard to Break, unnumbered page 2, available at https://www.whiteandwilliams.com/pp/alert-25.pdf (arguing that high-trust transacting ended because of the increase “in cessions involving environmental, asbestos and other longtail claims, coupled with the fact that an increasing number of ceding companies and reinsurers were in runoff. With runoff, the goal of maintaining a future relationship was gone, the need for arbitrations increased, and contentiousness . . . rose.”). Runoff occurs when a reinsurer stops underwriting new risks. “A runoff may take the form of a court-ordered receivership proceeding (liquidation, rehabilitation, or conservation), a supervised termination of active underwriting by the local regulator, an informal supervision by the local regulator, or merely a business decision to end active underwriting and place all existing contracts into a runoff mode.” Larry Schiffer, My Reinsurer Is in Runoff. What Do I Do Now? International Risk Management Institute, https://www.irmi.com/articles/expert-commentary/my-reinsurer-is-in-runoff.
A detailed analysis of cases around the time the industry began to grow rapidly and litigation began to increase might reveal other helpful information, such as whether the disputes that began to be litigated were the same kinds of disputes that had previously been arbitrated or disputes of a new kind. Was there an increase in opportunism, or an increase in differences of view between contracting parties about what their agreement required?

Appendix A: Incidence of Litigation

A case count was conducted by searching for decisions including the word "reinsurance" in all U.S. courts on Lexis Advance and refining the results using the terms "reinsurer or retrocessionaire or cedent or reinsured" to target cases between primary insurers and reinsurers. The facts or the overview of each case were then reviewed to make sure that they were cases between insurers and reinsurers.