

Second Circuit Says Cedent Cannot Use the “Follow-the-Settlements” Doctrine to Circumvent Plain, Unambiguous Policy Provision

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Reinsurance Alert

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In *Utica Mutual Insurance Company v. Fireman’s Fund Insurance Company*, the U.S. Court of Appeals for the Second Circuit, reversing a jury verdict in the District Court, held that the “follow-the-settlements” doctrine does not bind a reinsurer to settlement decisions that are inconsistent with the plain, unambiguous terms of the reinsured policy.

At issue in *Utica Mutual Insurance Company* was Fireman’s Fund Insurance Company’s (Fireman’s Fund) liability to its cedent, Utica Mutual Insurance Company (Utica), for payments Utica made to settle asbestos coverage litigation with its insured, Goulds Pumps, Inc. (Goulds). Between 1966 and 1972, Utica issued seven primary and umbrella policies to Goulds. Although the seven primary policies were missing at the time of the instant litigation, all seven umbrella policies were available for review. The umbrella policies expressly state that “[Utica] shall be liable only for the ultimate net loss resulting from any one occurrence in excess of...the amounts of the applicable limits of liability of the underlying insurance as stated in the Schedule of Underlying Insurance Policies.” The schedule of underlying insurance accompanying each umbrella policy lists two categories of primary coverage: bodily injury and property damage. The schedules list “per accident” and “aggregate” coverage limits for property damage claims, but only “per person/per accident” coverage limits for bodily injury claims, with no aggregate limit identified.

Fireman’s Fund reinsured the seven Utica umbrella policies under seven separate reinsurance contracts. Each of the reinsurance contracts contains a “follow form” clause, which provides that Fireman’s Fund’s liability “shall follow that of [Utica] and except as otherwise specifically provided herein, shall be subject in all respects to all the terms and conditions of [the umbrella policies].” Each of the reinsurance contracts also contains a “follow-the-settlements” clause, which provides that “[a]ll claims involving this reinsurance, when settled by [Utica], shall be binding on [Fireman’s Fund].”

Since the 1980s, Goulds has faced thousands of claims alleging bodily injury arising from exposure to its asbestos-containing products. As Goulds’ primary insurer, Utica initially provided a defense and indemnified Gould with respect to these asbestos bodily-injury claims. After several years of making payment, however, Utica took the position that its coverage obligations had been exhausted pursuant to aggregate limits in the missing primary policies. Goulds rejected Utica’s position, asserting that Utica was obligated to continue to indemnify Goulds for all asbestos-related claims up to the “per accident” limits specified in the primary policies. In 2003, Utica and Goulds filed competing declaratory judgment actions in California and New York state courts to address the extent of Utica’s coverage obligations. In 2007, Utica and Goulds reached a settlement, pursuant to which the parties agreed that (i) each primary policy is subject to an “aggregate” limit for bodily injury claims, (ii) the primary policy limits had been exhausted by Utica’s prior payments, and (iii) the remaining insurance available to pay claims amounted to \$325 million, which would come (in part) from the reinsured umbrella policies.

After settling with Goulds, Utica sought to collect the full limits of the seven reinsurance contracts (\$35 million in total) from Fireman’s Fund. Fireman’s Fund rejected Utica’s claim, asserting that the reinsured umbrella policies were not triggered until Goulds’ bodily injury losses exceeded the “per accident” primary limits specified in the schedules of underlying insurance, which had not occurred.

In response, Utica argued that, pursuant to the follow-the-settlements clauses in the reinsurance contracts, Fireman's Fund could not challenge the Utica-Gould settlement, which treated the underlying primary policies as having "aggregate" bodily injury limits that had been exhausted by prior claim payments. Thereafter, Utica filed a breach of contract action against Fireman's Fund in the U.S. District Court for the Northern District of New York. Following a 12-day jury trial, the jury found in favor of Utica, awarding a \$35 million judgment, plus pre-judgment interest of \$29,092,191.78 against Fireman's Fund, which it immediately appealed.

The Second Circuit reversed the jury's decision, concluding that Fireman's Fund is not liable to Utica under the subject reinsurance contracts. In so holding, the court noted that, per the plain language of the subject reinsurance contracts, "Fireman's Fund's liability follows from Utica's liability *consistent with the terms of the umbrella policies.*" *Utica Mutual Insurance Company*, Slip Op. at 3 (emphasis added). The court noted further that the terms of the umbrella policies unambiguously state that (i) the policies only provide coverage "in excess of...the applicable limits of liability of the underlying insurance as stated in the Schedule of Underlying Insurance Policies," and (ii) the accompanying schedules of underlying insurance clearly provide that bodily injury claims are subject to "per accident" rather than "aggregate" limits. *Id.* at 15-20. Taking these provisions together, the court reasoned, Fireman's Fund can only be held liable under the reinsurance contracts if the losses in question exceed the "per accident" limits of the underlying primary policies. *Id.* at 20.

Significantly, the court rejected Utica's "follow-the-settlements" argument, pointing out that the "follow-the-settlements" doctrine has "important limitations," including that it "does not alter the terms or override the language of reinsurance policies." *Id.* at 22 (citing *U.S. Fid. & Guar. Co. v. Am. Re-Ins. Co.*, 985 N.E.2d 876 (N.Y. 2013).) Applying the doctrine in this case, the court reasoned, would render the "follow form" provision in the reinsurance contracts meaningless, and "would be contrary to the parties' express agreement and to the settled law of contract interpretation." *Id.* at 23.

The court noted that its decision is "congruent with a continuous line of authority" in the Second Circuit establishing that "to trigger deference under the follow-the-settlements doctrine, the settlement decision in question must be reasonable and in good faith but *must also be within the terms of the reinsured policy.*" *Id.* at 24 (citing *North River Ins. Co. v. Ace Am. Reins. Co.*, 361 F.3d 134, 140 (2d Cir. 2004); *Mentor Ins. Co. (U.K.) v. Brannkasse*, 996 F.2d 506, 517 (2d Cir. 1993); *Christiania Gen. Ins. Corp. v. Great Am. Ins. Co.*, 979 F.2d 268, 280 (2d Cir. 1992)) (emphasis added).

Notably, the court did not address whether it would have strictly enforced the terms of the reinsured umbrella policies if the primary policies had been available and, despite the limits listed in the schedules of underlying insurance accompanying the umbrella policies, showed aggregate limits for bodily injury claims.

In closing, the court pointed out that its decision should not be interpreted to mean that Fireman's Fund is entitled to de novo review of Utica's "decision-making process," "claim liability determinations," or "decision[s] as to allocation." *Id.* at 25. The court stated further that the "follow-the-settlements" doctrine will "no doubt...apply in many other disputes." *Id.* It maintained, however, that "where, as here, the relevant policy terms are unambiguous, a reinsured cannot insulate itself from application of those terms under follow-the-settlements." *Id.*

The Second Circuit's decision in *Utica Mutual Insurance Company* is significant because, among other things, it raises the stakes in disputes concerning ambiguity of policy terms. Moreover, although the court made plain that its decision should not be construed as giving reinsurers authority to second-guess a cedent's liability and allocation decisions, it remains to be seen whether reinsurers will attempt to use *Utica Mutual Insurance Company* to erode the "follow-the-settlements" standard in cases where coverage under the reinsured policy is "arguable."

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