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Follow the Settlements Doctrine Applies to Ceding Insurer's Decisions Regarding Allocation of Settlement among Multiple Reinsurance Agreements

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Immature Record Prevents Summary Disposition of Allocation Dispute

Case at a Glance

The doctrine of follow the fortunes, sometimes termed follow the settlements, is a contractually based doctrine intended to simplify and expedite the administration of reinsurance agreements by preventing a reinsurer from re-arguing the claims decisions made by a ceding insurer in the ordinary course of business with respect to the payment of claims for losses to its insureds. The appellate court in this case found that the follow the settlements doctrine applied to the decisions of the ceding insurer as to how to allocate its loss payments to multiple reinsurance agreements which might cover that loss, subject to review for a determination as to whether the allocation decision was objectively reasonable. **Summary of Decision**

Kaiser Aluminum & Chemical Corporation was faced with hundreds of thousands of asbestos-related claims arising from asbestos exposure in its manufacturing plants and from its sale of asbestos-containing products, and additional claims arising from alleged exposure to benzene, volatile coal tar pitch and excessive noise at its manufacturing premises. These claims forced Kaiser into Chapter 11 bankruptcy in 2002. By 2006, Kaiser had an estimated total unliquidated liability for such claims of $2.5 billion and approximately $1.5 billion in solvent insurance coverage for such claims, approximately $568 million of which was written in 49 policies issued by several insurers which were under what the court described as common control. The policy at issue in this case was issued by New Hampshire Insurance Company, an AIG company, and provided $50 million of coverage in excess of $50 million underlying coverage, for a coverage period of three years. The 49

AIG policies provided coverage at various excess levels over a period of 15 years. The scope of coverage of the AIG policies was not identical. In particular, some of the AIG policies provided coverage for bad faith, premises liability and defense costs, but the New Hampshire policy did not provide coverage for such risks. Kaiser filed two declaratory judgment actions against its insurers, one in 2000 relating to asbestos-related claims and one in 2001 relating to premises-related claims. The 2000 asbestos declaratory action named New Hampshire and other AIG companies, including Lexington Insurance Company and Insurance Company of the State of Pennsylvania (ICOP). That action alleged bad faith claims against Lexington and ICOP, but did not allege a bad faith claim against New Hampshire. The court found that the ICOP policy obligated it to pay Kaiser's defense costs in addition to the limits of the policy. Lexington was the only AIG company named in the 2001 premises declaratory action; in particular, New Hampshire was not named in that action. Kaiser and the AIG companies (including New Hampshire) reached a global settlement, pursuant to which the AIG companies paid their remaining policy limits into a trust, in exchange for a full release of all claims, including the asbestos-related claims, the premises-related claims, the bad faith claims and the defense cost claims. The settlement did not allocate any of the settlement amount to any particular claims, policies, years or insurance companies. Rather, it provided that the "AIG Member Companies shall have the right to allocate the Settlement Amount, or any portions thereof, solely for its [sic] own purposes, in its own books and records, to the various types and classifications of claims under the Subject Policies released by [Kaiser]." New Hampshire billed one of its reinsurers, Clearwater Insurance Company, for its share of the settlement amount. Clearwater declined to pay, and New Hampshire sued it for payment. Clearwater challenged AIG's allocation of the settlement amount to the asbestos-related claims, and asserted three defenses arising out of contentions that New Hampshire had breached its reinsurance agreement with Clearwater by providing late notice and by breaching a warranty of retention. AIG allocated 100% of the settlement amount to asbestos-related claims, with 0% of the settlement amount being allocated to the premises, bad faith and defense cost claims, which also had been released by the settlement, and which were not covered by Clearwater's reinsurance agreement. AIG used what the court described as "a ground-up, rising bathtub approach" of horizontal exhaustion of reinsurance to allocate the reinsured liability to the various levels of reinsurance agreements, which covered asbestos-related claims. Clearwater did not dispute the use of the bathtub method of horizontal allocation; it did dispute the allocation of whatever consideration was paid for the release of the non-asbestos-related claims to the asbestos-related reinsurance agreements. The Appellate Division agreed with Clearwater's statement that "the question is not what methodology AIG uses to fill its bathtub, but rather, what AIG is *pouring into* its bathtub as an initial matter." While discovery was in what the Appellate Division described as "its infancy," with unresolved disputes over New Hampshire's allegedly insufficient document production and no depositions having been taken, New Hampshire filed a motion for summary judgment, contending that Clearwater was bound to "follow the fortunes" of its allocation decision and that it was entitled to judgment as a matter of law with respect to Clearwater's three defenses. The trial court denied summary judgment as to the allocation question but granted summary judgment as to Clearwater's defenses. The Appellate Division modified that ruling, affirming the denial of summary judgment on the allocation issue, albeit based upon different grounds than that stated by the trial court, but also denying summary judgment with respect to Clearwater's defenses. New Hampshire contended that there was a "follow the settlements" provision in the reinsurance contract, which bound Clearwater to its allocation of the settlement amount. A "follow the settlements" provision generally is applied to claims decisions made by an insurer rather than to settlement allocation decisions, and the trial court was not willing to find that the contractual provision was sufficient to support summary judgment in favor of New Hampshire. The Appellate Division agreed with the trial court that summary judgment was not appropriate on the allocation issue, but for a reason other than that articulated by the trial court. The court of appeal found that the policy provision at issue was not a typical "follow the settlements" provision, but rather a "follow the form" provision, which merely provided for concurrency between the reinsurance contract and the underlying policies, so that the reinsurance contract covered the same risks written in the reinsured policies. However, the Appellate Division held that even if the contractual provision was a "follow the settlements" provision, New Hampshire's allocation decision would not be completely "immunized" from judicial review, because any such allocation decision must be objectively reasonable, i.e., "[t]he reinsured's allocation must be one that the parties to the settlement of the underlying insurance claims might reasonably have arrived at in arm's length negotiations if the reinsurance did not exist." The Appellate Division found the record insufficient to enable it to determine whether New Hampshire's allocation decision was objectively reasonable as a matter of law, in particular "whether or not it was reasonable to allocate no portion of the settlement to claims that were not asserted against New Hampshire or were not even covered by its policy." The Appellate Division further found that disputed issues of material fact existed as to whether New Hampshire complied with the loss notice and reporting requirements of the reinsurance contract, whether Clearwater was prejudiced by any late notice, and that Clearwater was entitled to further discovery on the retention warranty defense. Therefore, the Appellate Division found that summary judgment was inappropriate with respect to Clearwater's defenses, resulting in the denial of summary judgment in all respects. *Reprinted with permission of Thomson Reuters, Inc. All rights reserved.*

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