

CASE ALERT:

New York's High Court Rules on Follow the Settlements.

On February 7, 2013, the New York Court of Appeals ruled in *USF&G v. American Reinsurance Co.*, a closely-watched case on the follow the settlements doctrine. Although the Court narrowed in two respects a summary judgment upholding a ceding company's allocation of a complex asbestos settlement, its ruling nevertheless confirms and arguably raises the high bar that reinsurers face when challenging their cedents' allocations. Here is a summary of some of the Court's key holdings:

Follow the Settlements Applies to Allocation.

The Court rejected the reinsurers' argument that follow the settlements should not apply to allocation because, "in that context the interests of a cedent and reinsurer will often conflict." While acknowledging some logic in the reinsurers' position, the Court concluded that "[t]o review each decision de novo would invite long litigation over complex issues that courts may not be well equipped to resolve ... Deference to a cedent's decision makes for a more orderly and predictable resolution of claims." Therefore, the Court joined the majority of courts which have found "no good alternative to giving a measure of deference to a cedent's allocation decisions."

A Reinsurer Must Follow Its Cedent's Objectively Reasonable Allocations.

Historically, reinsurers have focused on the subjective motivations underlying a disputed allocation to argue, with apparent support from certain cases, that an allocation chosen to maximize reinsurance recovery manifests "bad faith," and therefore need not be followed. The Court squarely rejected that approach, ruling that the cedent's subjective motives "should generally be unimportant." "Cedents are not," the Court held, "the fiduciaries of reinsurers, and [they] are not required to put the interests of reinsurers ahead of their own." Thus, the Court expressly confirmed that cedents can consider their reinsurance recovery when making their allocation decisions: "We think it unrealistic to expect that the cedent will not be guided by its own interests ..." Therefore, according to the Court, "objective reasonableness should ordinarily determine the validity of an allocation." This means that "[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."

That definition of objective reasonableness gives cedents broad latitude. An allocation qualifies as reasonable if the parties "might reasonably have arrived at" that allocation in arm's length negotiations absent reinsurance considerations. Accordingly, an allocation is only unreasonable if the parties could not possibly reasonably have arrived at it through their negotiations other than through collusive regard to reinsurance. In most cases, reinsurers will be hard-pressed to point to evidence sufficient to create a triable issue of fact under this broad, objective definition of reasonableness.

Applying this standard, the Court sustained summary judgment on certain aspects of the cedent's allocation, including the allocation of the entire settlement to a single policy-year even though multiple policies were settled. However, noting some "unusual" evidence in the record before it, the Court concluded that the reinsurers had raised triable issues concerning two aspects of the allocation -- the assignment of zero value to bad faith claims released in the settlement and the valuation of certain underlying claims seeking damages for asbestos-induced lung cancer.

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