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Second Circuit: "Follow The Settlements" Does Not Bind a Reinsurer to Settlements Inconsistent With The Unambiguous Terms of the Reinsured Policy

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On April 28, 2020, the Second Circuit Court of Appeals reversed a $64 million trial court judgment in favor of Utica Mutual Insurance Company ("Utica") and against Fireman's Fund Insurance Company ("Fireman's Fund"). The court rejected Utica's reliance on follow the settlements and held instead that because the umbrella policies issued by Utica did not cover the underlying asbestos losses, the facultative reinsurance certificates issued to Utica for those policies by Fireman's Fund likewise did not cover the losses. *Utica Mutual Insurance Company v. Fireman's Fund Insurance* Company, No. 18-828, 2020 WL 2047431 (2d Cir. April 28, 2020).

During the 1960s, 1970s and 1980s, Utica issued a series of primary and umbrella policies to Goulds Pumps. Goulds thereafter was a defendant in thousands of suits alleging bodily injury from its asbestos-containing products. Utica initially defended and indemnified Goulds against the asbestos claims under its primary policies. In the early 2000s, Utica took the position that its primary policies contained aggregate limits applicable to bodily injury losses and that those limits had been exhausted. Coverage litigation ensued to address that issue. In February 2007, Utica and Goulds settled their coverage disputes. As part of the settlement, Goulds agreed that each of its primary policies contained an aggregate limit applicable to bodily injury losses, and that those aggregate limits had been exhausted by Utica's prior payments.

Following the settlement, Utica began paying Goulds asbestos losses under its umbrella policies (which sat excess of the now "exhausted" primary policies), and then sought reimbursement from its reinsurers, including Fireman's Fund . Each of the umbrella policies facultatively reinsured by Fireman's Fund provided that Utica would 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 [primary] insurance [policies]," which were stated on a "per person" or "per accident" basis. As noted above, the primary policies as issued did not contain aggregate limits for bodily injury losses; those limits were effectively added later by Utica and Goulds pursuant to the settlement of the coverage action. Based on the lack of aggregate limits, Fireman's Fund denied liability for Goulds asbestos losses on the ground that none of the losses exceeded the "per person" or "per accident" limits in the primary policies, and, therefore were not covered by the reinsured umbrella policies.

Utica sued Fireman's Fund in the Northern District of New York to recover the reinsurance billings. Following a twelve-day trial, the jury returned a verdict in favor of Utica on its breach of contract claim and judgement was entered in Utica's favor in the amount of $64 million (which included $29 million of prejudgment interest).

The Second Circuit reversed. According to the court, the umbrella polices reinsured by Fireman's Fund clearly and unambiguously provide that Utica's payment obligation was triggered only if the losses in question exceeded the applicable "per person" or "per accident" limits in the primary policies. Because no individual loss exceeded the applicable limits, Utica had no liability under the umbrella policies, and, in turn, Fireman's Fund was not liable under the facultative certificates reinsuring those umbrella policies.

Utica argued that only occurrence limits were required to be listed in the Schedule of underlying insurance, but the Court was unpersuaded. The Court noted that Utica's argument would "render significant portions of the Schedules meaningless." Specifically, according to the Court, "the Schedules would serve very little purpose since, under Utica's approach, one could read into the Schedules limits not otherwise stated, even if doing so would directly contradict language in the umbrella policies." Accordingly, the Court held, "given the unambiguous language in the umbrella policies, Fireman's Fund had no obligation to pay for bodily injury claims that did not exceed [the 'per person' or 'per accident'] bodily injury limits identified in the Schedules."

In a footnote, the Second Circuit stated that it did not consider evidence proffered by Utica that the primary policies issued to Goulds did, in fact, contain aggregate limits. According to the Court, "[w]hatever the strength of that evidence, and whatever it may suggest about whether Utica and Goulds intended the umbrella policies to have such limits," such evidence (including the primary policies themselves) was extrinsic to the umbrella policies and, thus, was not admissible under New York law in interpreting the otherwise unambiguous umbrella policies.

Finally, the Second Circuit rejected Utica's argument that Fireman's Fund was obligated by the facultative certificates' follow the settlement clauses "to accept Utica's interpretation of the umbrella policies, as reflected in its 2007 settlement with Gould." Significantly, the Court noted that follow the settlements provisions have "important limitations," including that they cannot be relied on to "alter the terms or override the language of reinsurance policies." (*Quoting United States Fidelity & Guaranty Co. v. American Re-Insurance Company*, 985 N.E.2d 876, 882 (N.Y. 2013).) According to the court, "to trigger deference under the follow-the-settlements doctrine, the settlement decision in question must not only be reasonable and in good faith but must also be within the terms of the reinsured policy." (Citations omitted.) Thus, "where, as here, the relevant policy terms are unambiguous, a reinsured cannot insulate itself from the application of those terms under 'follow the settlements.'"

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