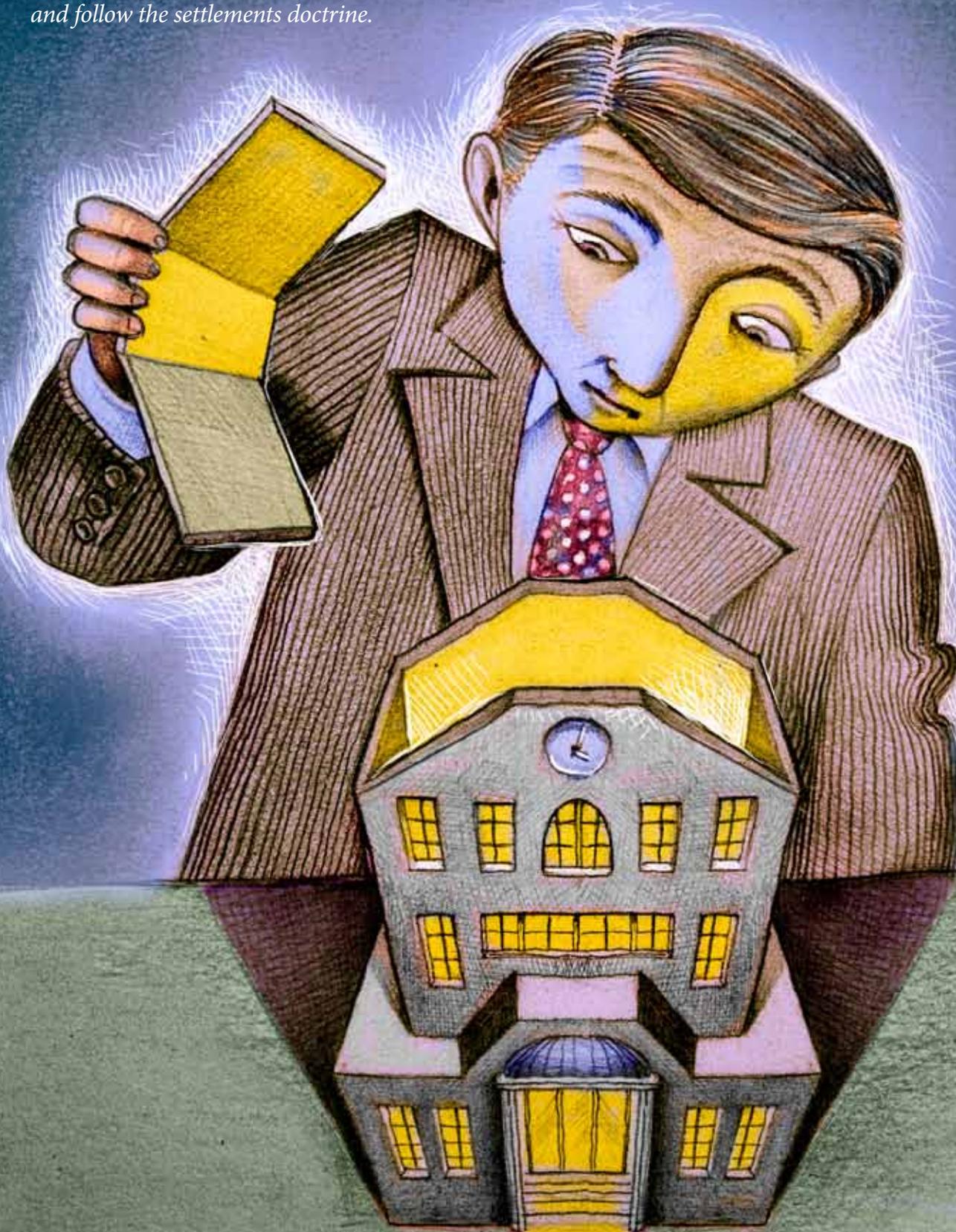


Trust...But Verify

Do Access to Records and Follow the Settlements Conflict?

Michael H. Goldstein and Mónica Matos-Desa explore the delicate balance between the access to records clause and follow the settlements doctrine.



Michael H. Goldstein & Mónica Matos-Desa

Access to Records

Reinsurers seek access to documents relating to underlying coverage and allocation issues in order to determine whether a cedant's settlements and allocations are reasonable, in good faith, and involve a covered claim. Often, they will request access to coverage counsels' opinions, communications with the insured and its counsel, claims adjusters' investigation reports and written analyses, and determinations of coverage and allocation issues. Such requests are typically made pursuant to an "access to records" clause in the reinsurance contract.

A typical access to records clause gives a reinsurer the right to "inspect, examine, audit and verify any of the policy, accounting or claim files relating to business reinsured" under the reinsurance contract, or require the cedant to "make available for inspection . . . all books, records and documents relating to the reinsurance certificate or claims."¹ In addition, a contract may require a cedant to provide reinsurers with "details of claims" or "particulars" of claims in loss settlement or loss reporting clauses.² Where the parties have "contractually" agreed to provide such information, they have implicitly agreed that the "particulars" or details of the underlying claims are relevant, and the terms of the agreement should control under basic contract law.

Typical access to records issues include:

- Should a reinsurer be current in payment of losses in order to gain access to records?
- Is coverage for claims settled by a cedant relevant?
- Is the cedant's rationale for settlement of claims relevant?
- Is the cedant's rationale for allocation of settlement amounts to its policies relevant?
- Is coverage counsel's advice relevant/privileged?
- Is in-house counsel's advice on coverage or allocation relevant/privileged?

- Are the cedant's claim handling and allocation decisions, and factual bases for those decisions, relevant?

Additional considerations that come into play when asserting a claim for records are confidentiality/non-waiver agreements, the right to review documents only versus copying of requested documents, and the role of the reinsurer's third-party representatives, *i.e.*, outside counsel or claims consultants.

Reinsurers often seek information regarding the allocation of complex claims involving multiple years and layers of coverage.

These issues aside, in accordance with typical access to records clauses, a cedant is obliged to provide full and complete disclosure to a reinsurer where the requested information is arguably relevant to the disputed claim(s), accounting and/or underwriting issues. Full disclosure of pertinent information in the formation, as well as performance of a contract, is the *sine qua non* of reinsurance. Furthermore, because information concerning underlying risk "lies virtually in the exclusive possession of the ceding insurer," reinsureds are obligated to provide prompt and full disclosure of material information to reinsurers.³ Such an obligation is owed in accordance with the principles of utmost good faith between the cedant and reinsurer.

A broad access to records clause allows a reinsurer to ascertain whether the reinsured is ceding business and calculating premium in accordance with the terms and conditions of the reinsurance contract.⁴ Reinsurers often seek information regarding the allocation of complex claims involving multiple years and layers of coverage. Although reinsurers are accorded broad rights of access to a cedant's records, access may be denied where the requests

are unreasonable.⁵ Moreover, some cedants will oppose complete access to their claims files because the requested documents are allegedly privileged and/or are "irrelevant" based on the follow the settlements doctrine. Other cedants will be forthcoming in making their direct claim files available, including coverage counsels' reports and analyses, as well as their internal coverage analyses and determinations, if underlying coverage disputes have been resolved. If coverage disputes are still pending, cedants might fairly place some limitations or restrictions on reinsurers' access to privileged communications with coverage counsel.

Follow the Settlements

Follow the settlements is a well-established reinsurance doctrine that "binds a reinsurer to accept the cedant's good faith decisions on all things concerning the underlying insurance terms and claims against the underlying insured."⁶ Stated another way, it prevents reinsurers from second guessing good-faith settlements and obtaining de novo review of determinations of the reinsured's liability to its insured, as long as the claim is arguably within the scope of the insurance coverage that was reinsured.⁷ In recent years, several courts have extended the application of follow the settlements to post-settlement allocations.⁸ Some cedants have relied on those decisions to severely limit reinsurers' access to documents that would presumably support the cedant's coverage/allocation decisions.

A reinsurer's duty to follow the settlements is not inherent in all contracts, although it has been considered customary within the industry to follow the doctrine even in the absence of an explicit clause.⁹ In a contract where there is no express "follow the settlements clause," contractual language requiring a reinsurer to reimburse its reinsured for underlying

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settlement payments may constitute a “follow the settlements” clause. In *Employers Reins. Corp. v. Mass. Mut. Life Ins. Co.*, for example, the contract language stated that “the Corporation shall reimburse the Reinsured or its legal representative promptly for loss against which indemnity is herein provided.” The court held that this language clearly constituted a “follow the settlements” clause.¹⁰

Defeating Application of Follow the Settlements/Follow the Allocation

A reinsurer has a heavy burden in attempting to defeat application of the follow the settlements doctrine, requiring a showing of gross negligence, recklessness, bad faith, “an extraordinary showing of a disingenuous or dishonest failure,” or that the settlement “was not even arguably within the scope of the reinsurance coverage.”¹¹ Follow the settlements is not absolute, however, and will not apply in a number of circumstances.¹² These circumstances include:

- Original claim is not even arguably covered – allocation is unreasonable and has no good faith basis in facts of the underlying claim;¹³
- Cedant’s expenses billed to the reinsurer are in excess of the stated reinsurance limit;¹⁴
- Settlement with the insured is fraudulent, in bad faith or a product of collusion;¹⁵
- Cedant breached its duty to adjust the claim in a prudent businesslike manner by reckless or grossly negligent conduct.¹⁶

Access to Records v. Follow the Settlements/Follow the Allocation

Follow the settlements does not preclude a reinsurer from discovery into whether the reinsured’s liability stems from an unreinsured loss.¹⁷ A party’s refusal to provide access to records based on the position that the reinsurer must simply follow its settlements would nullify a reinsurer’s right of access to records and claim details, hindering the reinsurer’s ability to determine if a cedant’s actions

are in compliance with contractual obligations.

Follow the settlements language cannot be used to override the actual terms of a reinsurance agreement; instead, the parties’ bargain must be enforced as written.¹⁸ Under New York law, “effect and meaning must be given to each term of the contract, and reasonable effort must be made to harmonize all of its terms.”¹⁹ The position that a reinsurer is unable to access documents pertaining to an underlying claim, for the purpose of determining whether the loss was covered under a contract, would contravene basic contract law and overturn a fundamental underpinning of the reinsurance relationship.

...follow the settlements should not override an access to records clause if the documents are sought for the purpose of determining whether the loss is covered by the contract.

A follow the settlements clause should also not trump the broad federal rules of discovery if the relevant forum is federal court. Under Fed. R. Civ. P. 26(b)(1), parties may obtain discovery regarding any unprivileged matter that is relevant to any party’s claim or defense. Indeed, the Federal Rules allow discovery “encompass[ing] any matter that bears on, or that reasonably could lead to other matters that could bear on, any issues that is [sic] or may be in that case.”²⁰

Thus, follow the settlements should not override an access to records clause if the documents are sought for the purpose of determining whether the loss is covered by the contract.

Recent Developments in Case Law

In *Hartford Acc. & Indem. Co. v. Argonaut Ins. Co.*, 2008 U.S. Dist. LEXIS 47985 (D. Conn. 2008), the court found for the cedant, upholding its argument

that the follow the settlements clause overrode the access to records clause in that case. The reinsurance contract at issue contained both an access to records clause and a follow the settlements clause. The reinsurer suspected that the cedant acted in bad faith in billing a claim and therefore refused to pay the cedant’s bill and demanded the cedant’s records. The documents at issue contained all of the cedant’s primary and excess policies, data on all available reinsurance, and loss reserves data.

Based on Second Circuit case law,²¹ the court found that an inconsistency in how its reinsured evaluated and settled the underlying claim and ceded the claim was not sufficient to overcome the follow the settlements clause, and therefore discovery into the inconsistency was not relevant or a proper subject of inquiry. In upholding the follow the settlements clause as a shield to the reinsurer’s right of access to records, the court stated “if all policies involved in the underlying insurance dispute were turned over to the reinsurers, the entire follow the fortunes doctrine would be undermined.” The court continued by noting that “the protections afforded insurers would be illusory, settlements would be discouraged and the door would be wide open for reinsurers to relitigate and seek judicial review of every settlement.”

In *Travelers Cas. & Sur. Co. v. Century Indem. Co.*, Civ. No. 3:10CV400, 2011 U.S. Dist. LEXIS 132131 (D. Conn. Nov. 16, 2011), the court found that certain documents were to be produced to the reinsurer as relevant, while limiting the disclosure of other types of documents under the access to records clause. There, the cedant paid asbestos-related loss claims, then billed the reinsurer, allocating losses as ‘one loss.’ The reinsurer refused to pay, alleging that the cedant did not act in good faith in assessing and allocating asbestos-related losses. The documents at issue included all of the cedant’s memos, letters, and papers relating to the cedant’s billing as a single loss occurrence, and the cedant’s underlying coverage determination. The

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cedant argued that the documents were too broadly defined and largely irrelevant, that they were privileged, and that the privilege had not been waived.

As to the reinsurance billing documents, critically, the court found that the “information regarding the evaluation of the reinsurance claims is relevant to this lawsuit.” The court ordered the cedant to provide “all documentation evaluated and/or relied on by the [cedant] in reaching its ‘theory that the claims against [cedant’s insureds] constitute a single reinsurance occurrence,’” which included, but was not limited to, “any memos, correspondence, documents, materials relied on, analyses, evaluations regarding its theory on reinsurance billing . . . relied on.”

As to the cedant’s underlying coverage determination documents, the court found that the “first step should focus on discovery into [cedant’s] evaluation of its losses with regard to a single loss presentation of claims on the reinsurance treaty.” The court did agree with the cedant that the access to records clause did not permit the reinsurer to “learn of any and all legal advice obtained by a reinsured with a reasonable expectation of confidentiality.” Thus, the court rejected the reinsurer’s document request with respect to underlying coverage documents.

The New York Court of Appeals recently decided a major reinsurance allocation dispute in a way that will have significant impact on the way cedants and reinsurers analyze their conflicting rights and obligations under a contract which has follow the settlements provisions, and perhaps the manner in which cedants and reinsurers interpret their rights under access to records clauses and other reporting requirements.

In *USF&G et al.*²² the Court of Appeals partially reversed summary judgment the trial court had granted *USF&G* on a reinsurance billing arising from asbestos claims it settled with its insured for \$975 million, plus \$12.3 million in fees to counsel for the asbestos claimants. The reinsurers challenged the allocation of the settlement to the excess of loss reinsur-

ance contract on which they participated. The trial court had granted and the appellate division affirmed summary judgment for *USF&G* according the cedant a very high level of deference based on follow the settlements allowed cedants in settling and allocating claims.

In reversing summary judgment on two of three grounds the Court of Appeals held: “But to say that a cedant’s allocation decisions are entitled to deference is not to say that they are immune to scrutiny.” The Court further found that in scrutinizing allocation decisions, “objective reasonableness should ordinarily determine the validity of an allocation” which the Court explained “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.”

Reinsureds are obligated to provide prompt and full disclosure of material information to reinsurers.

In light of finding this, the Court then proceeded to scrutinize the *USF&G* allocation decisions in considerable if not excruciating detail. It is evident from the decision, as well as the briefs and the oral arguments, that there was considerable discovery regarding underlying coverage dispute between *USF&G* and its insured as well as the settlement negotiations between them. It is also possible although not entirely clear that privileged communications were produced in discovery. Certainly it seems that work product was produced. *USF&G* also apparently submitted affidavits of its executives who were engaged in the negotiations. It also seems clear from the record that *USF&G* produced, whether voluntarily or not, a very large volume of documents from its direct claim files.

One conclusion that can be drawn by implication, among many from *USF&G*,²³ although the Court did not specifically

address the issue, is that at least under New York law, cedants cannot make broad unilateral decisions unreasonably restricting reinsurers’ access to records and claim detail based on a sweeping and overbroad interpretation of follow the settlements to shield their settlement and allocation decisions from the scrutiny of reinsurers and courts.

In sum, follow the settlements should not supersede an access to records clause if the reinsurer’s request is reasonable and relevant to the disputed claim or underwriting / accounting issues. Reinsureds are obligated to provide prompt and full disclosure of material information to reinsurers. While a cedant has the unilateral right to impose limits on access to records in order to protect its attorney-client privilege in connection with pending coverage litigation with its insured, the cedant’s cooperation with a reinsurer’s reasonable record requests regarding coverage/allocation decisions will reduce expensive and time-consuming disputes. ●

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Michael H. Goldstein, a Partner at Mound Cotton Wollan & Greengrass, specializes in reinsurance dispute resolution, litigation, arbitration, trials, appeals involving property, casualty, life, health, personal accident, title, error and omissions, and insurance and reinsurance contract wordings.
mgoldstein@moundcotton.com

Mónica Matos-Desa is an Associate at Mound Cotton Wollan & Greengrass.
mmatosdesa@moundcotton.com