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The Edges of Follow the Fortunes

October 2, 2019 By Jason B. Eson

Ask two reinsurance experts to define the parameters and limitations of Follow the Fortunes ("FTF") and you will, undoubtedly, receive two different responses. Provide these experts with a fact pattern and ask whether FTF applies, and you are still likely to receive inconsistent answers. It hardly matters whether the experts have more experience on the ceded or assumed side of the business. Compare the two expert

explanations with a court's definition of FTF and it is easy to be left wondering how a "doctrine," as a cedent is quick to characterize it, originating 200 years ago can still be something that is not universally understood and applied.

The uncertainty surrounding FTF — not helped by the fairly narrow scope of case law delineating its parameters — permits cedents and reinsurers (and their eager counsel) to push expansion or contraction of its application, even though the concept dates back to the early 1800s. It is an ever evolving doctrine, no doubt attributable to new exposures that implicate multiple policy years. These "continuous injury" claims introduce the allocation process, which adds an additional level of confusion and uncertainty as to where the boundaries of FTF end, and the limitations begin. And while FTF did not originate in America, it has become an American Pastime of sorts for the industry and its participants here.

The baseball analogy is apt here. When it comes to a reinsurance dispute, FTF in many ways is the cedent's old, reliable fastball. It is not going to be the only pitch in the arsenal but it is typically the most used and reliable. Of course, the reinsurer knows it is coming and is prepared to limit its effect. But a fastball comes in many variations — a four-seamer, a two-seamer, a cutter, a splitter – and is designed to get by even the most thoroughly prepared batter, often with devastating impact. Making matters more complicated, the strike zone changes depending on the size and stance of the batter and the umpire calling balls and strikes.

The venue hosting the FTF battle will often influence which party attempts to take advantage of the edges and gray area of the doctrine. A court, usually uninitiated in the nuances of FTF, offers the cedent the best opportunity to enlarge application. Arbitration, presided over by seasoned industry insiders with practical knowledge of FTF, permits the reinsurer more latitude to assert limitations. But these generalizations, of course, depend on context, the specific issues raised by the parties, and the complete neutrality of the umpire selected to preside over a dispute.

When defining FTF, especially in court, the cedent inevitably cites to the broadest, most nebulous application of the doctrine, *e.g.*, that it "binds a reinsurer to accept the cedent's good faith decisions on all things concerning the underlying insurance terms and claims against the underlying insured: coverage, tactics, lawsuits, compromise, resistance or capitulation." *N. River Ins. Co. v. ACE Am. Reins. Co.*, 361 F.3d 134, 139-40 (2d Cir. 2004). This is the cedent's "mic drop" moment – simply recite this all-encompassing definition, and "pay up, reinsurer."

The reinsurer, for its part, is quick to point to one of the established limitations to application. For example, the reinsurer may contend that the cedent's coverage decisions were unreasonable, made in bad faith, and do not extend to *ex-gratia* payments. *See Travelers Cas. & Sur. Co. v. Certain Underwriters at*

Lloyd's of London, 96 N.Y.2d 583, 596 (N.Y. 2001); *Granite State Ins. Co. v. ACE Am. Reins. Co.*, 849 N.Y.S.2d 201, 203 (N.Y. App. Div. 2007).

This article explores some of the blurry corners and edges of the following concepts, addressing whether:

(1) FTF is applicable to an insurer's decision to volunteer coverage to its policyholder;

(2) a cedent can imply following concepts into reinsurance contracts that do not contain an express FTF or Follow the Settlements ("FTS") provision; and

(3) FTF and FTS are truly interchangeable as sometimes applied by the courts.

- **Whether FTF Is Applicable To An Insurer's Decision To Volunteer Coverage**

The imprecise nature of FTF has opened up some different lines of defense for a reinsurer. Instead of arguing a limitation to application, and thus triggering a deferential review of a cedent's previous coverage determination, there are circumstances where a reinsurer may be in position to contend that FTF is inapplicable in the first instance. Questions of applicability may arise when an insurer volunteers coverage to its insured and then relies on FTF to support its reinsurance presentation. The issue becomes whether a reinsurer is bound to FTF where there was never any coverage dispute between the cedent and its insured. In other words, what precisely is the "fortune" that the cedent is asking the reinsurer to follow?

At the core of FTF is the notion of fortuity. Pursuant to this principle, a reinsurer can argue that it is only bound to follow fortuitous, uncontrollable events. Court judgments and arbitration rulings concerning coverage disputes certainly qualify as uncontrollable events. Industry literature and court rulings discussing the parameters of FTF lend credence to requiring a coverage dispute and subsequent resolution, typically in the form of a court judgment, as a prerequisite to application of FTF.[1] Conversely, if a cedent waives policy terms, conditions or potentially applicable exclusions, chance is removed from the equation, and FTF should not apply.

In response, a cedent would likely contend that this is a strained understanding of FTF and the case law does not limit application of the doctrine to disputed issues. *See*, *e.g.*, *Mentor Ins. Co. v. Brannkasse*, 996 F.2d 506, 517 (2d Cir. 1993)(FTF "simply requires payment where the cedent's good-faith payment is at least arguably within the scope of the insurance coverage that was reinsured."); *Christiania Gen. Ins. Corp. v. Great Am. Ins. Co.*, 979 F.2d 268, 280 (2d Cir. 1992)("A reinsurer cannot second guess the good faith liability determinations made by its reinsured, or the reinsured's good faith decision to waive

defenses to which it may be entitled.") While very few cases address FTF, even fewer touch on the issue of whether the "doctrine" should apply to coverage determinations made free of any dispute with the insured. At least in the context of litigation, a cedent will point to this lack of precedent to preclude its reinsurer from attempting to "create" new limitations to the doctrine.

There is another fundamental reason why FTF is arguably inapplicable to an insurer's decision to volunteer coverage: the alignment of interest between an insurer and reinsurer is jeopardized, and possibly shattered by an insurer's actions. As described by the Second Circuit in *North River/Cigna*,

"Follow the fortunes" forecloses relitigation of coverage disputes because **when an insurer disclaims coverage its interests are generally aligned with those of its reinsurer**. Permitting reinsurers to **re**visit coverage issues would place insurers in an untenable position.

52 F.3d at 1204 (emphasis supplied).

In those instances where an insurer determines to extend coverage voluntarily – *e.g.*, the insurer ignored, or made a business decision on, a coverage issue – the reinsurer loses the benefit and protection of the cedent acting in a deliberate fashion to minimize its, and its reinsurer's, exposure. The interests of the cedent and reinsurer are not in alignment at that point and there is no justifiable basis to accord deference to the cedent's "coverage decision."

In a similar vein, the reinsurer can argue that deference to the cedent's volunteering of coverage is unwarranted because there would be no revisiting or second-guessing of the cedent's coverage decision. Rather, the reinsurer is simply exercising its right to test the *bonafides* of the "coverage decision" for the first time. There was no *de novo* determination, therefore FTF is inapplicable: "What follow the fortunes does is to eliminate the possibility of the reinsurer's asking a court or an arbitration panel for a *de novo* determination…" Clifford H. Schoenberg, *L'Historie Ancienne De "Follow the Fortunes"*, Mealey's Litigation Reports (Reinsurance), May 28, 1992, at 17 (*cited by North River/Cigna*, 52 F.3d at 1204).

The cedent would likely counter this line of argument by reframing the fundamentals underlying FTF to its advantage. One of the main purposes of FTF, after-all, is to foster efficiency in the insurance and reinsurance businesses. *See North River/CIGNA*, 52 F.3d at 1205 (FTF "protects the risk transfer mechanism by providing that covered losses pass uninterrupted along the risk transfer chain.") Encouraging a cedent to raise a coverage issue, only to eventually capitulate or become embroiled in a coverage dispute, will only serve to increase disputes both on the direct and reinsurance levels and undermine the rationale behind FTF. *See Travelers Cas. & Sur. Co. v. Certain Underwriters at Lloyd's of London*, 96 N.Y.2d 583, 596 (2001)("The rationale behind this doctrine is two-fold: first it meets the goal

of maximizing coverage and settlement and second, it streamlines the reimbursement process and reduces litigation by preventing a reinsurer from continually challenging the propriety of a reinsured's settlement decision.")

Moreover, the cedent would likely argue that established limitations and exceptions to the application of FTF offer the reinsurer other safeguards in the event that it volunteered coverage that did not exist or that its motives were allegedly not aligned with the reinsurers. In other words, the reinsurer's argument is subsumed within other limitations and is merely designed as a burden-shifting tactic. For example, assuming application of FTF, a reinsurer that disagrees with a cedent's coverage "decision" may be required to prove that the underlying policy unambiguously does not provide the coverage at issue. *See*, *e.g.*, *Travelers Cas. & Sur. Co. v. Ins. Co. of N. Am.*, 609 F.3d 143, 165 (3d Cir. 2009)("*INA*") ("[The reinsurer] was required to show that, under Michigan law…the 'underlying policy language… unambiguously provides that' the per-occurrence limits are not subject to the treatment [the cedent] gave them…") By arguing that FTF is inapplicable, the reinsurer is essentially dodging its burden in favor of a *de novo* review.[2]

In the event the reinsurer has a basis to question the cedent's motives or professionalism in volunteering coverage, the reinsurer is protected by the "bad faith" exception to FTF. *See North River/Cigna*, 52 F.3d at 1212 (a breach of the duty of good faith is established where the reinsurer proves the reinsured acted with gross negligence or recklessness). Proving gross negligence or recklessness (or even more extreme conduct) is of course a factually intensive exercise. A cedent can use this fact as support for analyzing the record under a FTF paradigm. Placing a cedent's actions under the microscope warrants placing the burden of persuasion on the reinsurer. Indeed, imposing a burden on the reinsurer functions as a checks and balances system and forces the reinsurer to carefully consider whether to pursue what will surely be a costly and lengthy discovery process.

There may be occasions where the cedent's decision does not rise to the level of bad faith. The decision may well have been motivated by commercial or business considerations rather than a true coverage determination. Examples are:

1. granting coverage to avoid establishing precedent as to the scope of coverage provided by the reinsured policy or the desire not to test the applicability of a policy exclusion;
2. failing to require the original insured to comply with policy considerations or waiving enforcement of policy provisions such as a batch clause;
3. affording coverage in questionable circumstances to curry favor with the insured to renew coverage or to expand the existing insurance relationship; or
4. in a FTS rubric, compromising the claim solely to avoid the risk of losing at trial, despite hard

evidence that the insured had no reasonable expectation of coverage.

Issues of this nature typically invite the question of where to draw the line between insurance fortunes and business fortunes. Commercially responsible reinsurers will follow the insurance fortunes of their cedents, but may hesitate to follow their business or commercial fortunes. These issues are always fact sensitive, and the ability of the reinsurer to demonstrate the cedent's motive will generally depend on the quality of the cedent's record-keeping. So, as a practical matter, the cedent is well advised not to leave a paper trail as to why coverage is being granted.

No analysis of a reinsurance issue is close to complete without some discussion of contract wording. Needless to say, a reinsurer will need to familiarize itself with the specific FTF/FTS language used in its facultative certificate, assuming that such clause is present. Especially in court, where a judge is more likely to conflate FTF with FTS, a reinsurer could attempt to use a clause containing FTS language to its advantage.

A hypothetical, based in part on some facts presented in a well-known reinsurance case, may assist in illuminating this potential line of argument. In *North River/Cigna*, the Second Circuit analyzed the coverage dispute under the FTF doctrine based on the existence of a FTS clause in the facultative certificate. Specifically, the FTS provision provided in relevant part: "All claims involving this reinsurance, when settled by [North River], shall be binding on [CIGNA Re],…." 52 F.3d at 1204. According to the court, FTF was the applicable doctrine because the insurer and policyholder went to a binding arbitration on a coverage issue. Cigna Re was bound by the adverse ruling against North River.

But, what if there was no arbitration ruling (or subsequent settlement) and Cigna Re was simply being asked to follow North River's voluntary coverage grant to its insured based on the same FTS (not FTF) language? In such circumstance, Cigna Re would be justified in relying on the FTS language in its facultative certificate as further support for its position that FTF does not apply to an insurer's decision to volunteer coverage. The clause binds the reinsurer to "settled" claims. In essence, the clause contemplates, and arguably requires, the resolution of a controversy between the cedent and policyholder before binding the reinsurer.

A cedent would argue that a review of the certificate language actually undermines the reinsurer's position. For instance, the clause offers no limitation to only require the reinsurer to follow the cedent's coverage determinations or settlements of issues that were disputed.

Finally, it bears noting the possibility of a different outcome in court, as opposed to an arbitration, on the issue of whether FTF applies to a voluntary coverage grant. As noted above, there is a dearth of

court decisions directly addressing this issue. Consequently, a reinsurer would be hard-pressed to avoid the elastic parameters of FTF as applied by courts. *See*, *e.g.*, *N. River*, 361 F.3d at 139-40 (that FTF "binds a reinsurer to accept the cedent's good faith decisions on all things…")(emphasis supplied). As compared to an arbitration panel, a court (and potentially a jury) is more likely to buy a cedent arguing that "all things" means all things, including a cedent's "good-faith" determination to offer coverage to its insured. After all, a court or jury may be more inclined to balance macro-level considerations inevitably pushed by the cedent, *e.g.*, an insurer should not be penalized for being generous with its policyholder and extending additional coverages.

An arbitration panel, on the other hand, is more likely to consider the unique, fact-sensitive dynamics at play at between the cedent and reinsurer. In the process, a panel is less likely to bend over backward to find/maximize coverage (as courts are sometimes inclined to do). Perhaps more significantly, while a court would rather avoid making waves in an industry it has had some trouble (or willingness) grasping, the confidential nature of arbitration permits the panel some insulation from industry scrutiny and provides a better venue for a reinsurer to argue the nuances of FTF.

- **Implying Following Provisions Into Reinsurance Contracts Issued Without Them**

A cedent's reliance on the FTF and FTS doctrine to bind its reinsurer may be rejected by a court (likely) or arbitration panel (less likely) if the reinsurance contract does not contain an express FTF or FTS provision. Depending on the venue and which state's law applies to the dispute, a reinsurer may be in a better position now more than ever to capitalize on the absence of a FTF provision, and in the process avoid application of a following concept and force the cedent to prove coverage under the reinsured policy. Recent decisions handed down by the Second Circuit and the Northern District of New York have added some clarity as to whether and in what circumstances a cedent can successfully imply following provisions into a reinsurance contract that does not contain such express provisions. At least under New York law, it is an uphill battle for a cedent to convince a court to imply following provisions into a reinsurance contract.

Clearly, there are circumstances where a reinsurer may be better off litigating in court.

- **Whether to Imply a Following Provision/Doctrine As A Matter of Law**

In a recent Northern District of New York action involving Utica Mutual Insurance Company and Munich Reinsurance America, Inc., the court rejected Utica's argument advanced during the summary judgment stage that the FTF/FTS doctrines should be implied, as a matter of law, into a facultative certificate issued without containing such a provision. *See Utica Mut. Ins. Co. v. Munich Reins. Am., Inc.*,

No. 6:12-cv-00196, 2018 WL 1737623, at *21-22 (N.D.N.Y. Mar. 20, 2018)("*Utica/Munich Re*"). Shortly after the NDNY's summary judgment ruling, the Second Circuit found in another case that a FTS obligation should not, as a matter of law, be implied into reinsurance certificates involving Utica and another reinsurer. *See Utica Mutual Ins. Co. v. Clearwater Ins. Co.*, 906 F.3d 12, 17, 25 (2d Cir. 2018) ("We see no reason to read such a term into the contract by implication. Instead we follow the New York Court of Appeals' instruction: where a contract is 'reasonably susceptible of only one meaning, a court is not free to alter the contract to reflect its own personal notions of fairness and equity.'") (internal citations omitted).

Those few courts that have thoroughly considered whether FTF or FTS can be implied into a reinsurance contract that does not contain an express provision generally hold that it is a question of fact and look to extrinsic evidence such as industry custom and practice. As discussed below, courts should be, and are, reluctant to imply a term into an agreement between sophisticated parties. *See* Graydon S. Staring & Dean Hansell, *Law of Reinsurance*, § 18:2, at 423 (2017)("Early scholarship…, the best of modern scholarship, the judicial history of the subject…and the general law of contractual indemnity unite in confirming that there is no implied general obligation to follow settlements in the absence of an express clause to that purpose.")

- **Whether to Imply A Following Provision/Doctrine Into a Reinsurance Contract As A Matter of Fact**

Courts that have addressed this issue look to the specific contracts at issue between specific parties involved in the particular case. Oftentimes the decisions turn on expert testimony – sometimes unrefuted. *See*, *e.g.*, *Aetna Cas. and Sur. Co. v. Home Ins. Co.*, 882 F.Supp. 1328, 1349-1350 (S.D.N.Y. 1995) (making a factual finding based on uncontroverted expert testimony that it was custom and practice in the reinsurance industry to imply an obligation to follow settlements into all reinsurance contracts); *Trenwick Am. Reins. Corp. v. IRC, Inc.*, 764 F.Supp.2d 274, 297 (D. Mass. 2011)(making a factual finding based on experts presented by both parties, who consistently testified to the effect that the FTF doctrine is a "core tenet of the reinsurance business"). It should be noted that since such decisions are based on factual determinations, they have no precedential effect on other reinsurance actions involving different parties. *See Tug Helen B. Moran, Inc. v. Moran Towing and Transp. Co.*, 607 F.2d 1029, 1031 (2d Cir. 1979).

The summary judgment ruling in *Utica/Munich Re* did not foreclose Utica on the issue of whether the FTF doctrine may be implied into Munich Re's certificates as a matter of fact, and the court permitted Utica to present evidence at trial.[3] Under New York law, Utica had the burden at trial to prove that following provisions were, at the time the parties agreed to the certificates in the 1970s, so "fixed and invariable" in the reinsurance industry as to be part of the certificates. *See Utica Mutual Ins. Co. v.*

Munich Reinsurance America, Inc., 381 F.Supp.3d 185, 205-206 (N.D.N.Y. 2019)(relying on a number of cases, including, *British Int'l Ins. Co. v. Seguros La Republica, S.A.*, 342 F.3d 78, 83 (2d Cir. 2003)).

At trial, Utica presented testimony from three expert witnesses, "all of whom testified that follow the fortunes and follow the settlements were industry-wide concepts that did not need to be stated in reinsurance certificates to apply." 381 F.Supp.3d at 206. The court found this expert testimony "credible," but noted that two of the experts "acknowledged that not all reinsurers included these provisions in their reinsurance certificates" during the relevant time period. *Id*. at 207-208. In particular, Munich Re's certificates never included a FTF/FTS provision. These facts were significant to the court because one Utica expert conceded that there may be specific reasons why a reinsurer would elect to omit a FTF provision from its certificate. *Id*. The court considered that FTF may be a concept that Munich Re (and other reinsurers) practice in its business dealings, but not something they consider part of the contract.

Moreover, the court found that the language actually contained in the Munich Re certificates was inconsistent with an intent to include a FTF provision.[4] Accordingly, the court concluded that "Utica has failed to prove that follow the fortunes or follow the settlements were so 'fixed and invariable' in the facultative reinsurance industry as to warrant importing them into the 1973 Certificate as binding terms." Consistent with the recent Second Circuit decision in *Utica/Clearwater*, the burden was placed on Utica to prove that it was liable to its insured for defense expenses under the reinsured 1973 umbrella policy. The court ultimately found that Utica fell well short of sustaining its burden of proving coverage.

In addressing whether FTF is implied, the outcome might, again, vary depending on the forum. As these recent federal decisions involving Utica make clear, courts are "extremely reluctant to interpret an agreement as impliedly stating something which the parties have neglected to specifically include." *Vermont Teddy Bear Co. v. 538 Madison Realty Co.*, 1 N.Y.3d 470, 475 (2004). On the other hand, arbitration offers a cedent a more favorable venue for invoking the following concepts, even in the absence of contractual provisions binding the reinsurer to FTF/FTS.

Meeting a court's demanding "fixed and invariable" standard requires overcoming a number of tough obstacles in this context. Since many reinsurance disputes involve long-tail claims implicating contracts from decades ago, locating fact and expert witnesses with personal knowledge and experience from that time period is unlikely. During the *Utica/Munich Re* trial, neither party presented fact witnesses that were involved in the negotiation and underwriting of the 1973 certificate at issue.

Expert witnesses, therefore, play an outsized role at the trial. However, it is more likely than not that each party's slate of experts effectively nullify one another. For a cedent, this will not cut it under the "fixed

and invariable" standard. It is difficult for a cedent to prove that the following doctrines were so "uniform" in the 1970's, when the reinsurer is able to proffer testimony to the contrary from experts possessing decades of industry experience.

A cedent is better off trying its hand in the context of arbitration, where a panel is not required to enforce such strict rules of contract interpretation and construction. Relieved of judicial restraints and from following strict rules of law, an arbitration panel is not likely to require that a cedent prove the "fixed and invariable" standard, or to require a cedent to prove that a loss or item of expense was covered by the reinsured policy even if the reinsurance contract lacked following provisions. Absent language in the reinsurance contract evincing an intent to be bound only to pay losses or expenses actually covered by the reinsured policy, a panel is more likely to deliver an award that it deems most fair and equitable under the circumstances before it. For example, a panel is likely to support a cedent's reinsurance presentation if it finds the same to have been reasonable and made in good faith regardless of whether coverage was debatable — even though the reinsurance contract does not contain following provisions.

- **Are the Following Concepts Interchangeable?**

The question of which of the two doctrines to apply to a particular claim, addressed only passingly in the *Utica/Munich Re* decision, has befuddled the courts. Even though FTF and FTS are two different concepts, many courts and litigants conflate them, and frequently use the term "follow the fortunes" when discussing the application of FTS. *See New Hampshire Ins. Co. v. Clearwater Ins. Co.*, 7 N.Y.S.3d 38, 45 n.5 (N.Y.App. Div. 2015)(noting the confusion and discussing the differences in the concepts); *Trenwick*, 764 F.Supp.2d at 295 n. 23 ("The relevant case law refers not only to the 'follow the fortunes' doctrine, but also to the separate, yet related, 'follow the settlements' doctrine. Plaintiffs initially chose to use the broader term 'follow the fortunes' to refer to both doctrines…").[5] Therefore, when reviewing the case law, the focus must be on the nature of what is being analyzed (a failure to disclose, a payment, a settlement, a judgment, an allocation), and not on the specific term used.

Some courts have referred to follow the settlements as "follow the fortunes doctrine in the settlement context." *See*, *e.g.*, *North River Ins. Co. v. ACE Am. Reins. Co.*, 361 F.3d 134, 136 n.2 (2d Cir. 2004). While this formulation is incorrect in the sense that it fails to distinguish between fortuitous events (uncontrollable) and a cedent's actions (controllable), it does support that, when there is a settlement, follow the settlements is the relevant doctrine.

If courts neglect to take a firm and consistent position on the contours of the two doctrines, cedents can assume prime position to abuse the doctrines to its advantage. Specifically, a cedent can pick and choose between them to support and maximize its reinsurance billings. There may be no precedent permitting

mixed applications of the doctrines, but neither is there an abundance of case law expressly rejecting a cedent's efforts to do so.

The allocation process is one area that may be ripe for abuse and manipulation. There is no recognized, stand-alone concept known as "follow the allocation." Nonetheless, the case law seems to indicate that deference is accorded to a cedent's allocation decisions, and that such deference is derivative of FTS, not FTF. This concept was first expressly mentioned in a Massachusetts District Court decision in 1998. *See Commercial Union Ins. Co. v. Seven Provinces Ins. Co.*, 9 F.Supp.2d 49 (D. Mass. 1998), *aff'd* 217 F.3d 33 (1st Cir. 2000), *cert. den.*, 531 U.S. 1146 (2001). It has since been analyzed and applied by only a handful of courts, including the New York Court of Appeals. *See, e.g., INA,* 609 F.3d 143; *USF&G.,* 985 N.E.2d 876 (N.Y. 2013) ("*USF&G*")*; Allstate Ins. Co. v. Am. Home Assur. Co.*,837 N.Y.S.2d 138 (N.Y. App. Div. 2007), *lv. to app. den.*, 890 N.E.2d 246 (N.Y. 2008).

The *USF&G* case, which introduced the "objective reasonableness" test,[6] is usually at the forefront of any dispute over a cedent's allocation decisions. Of course, both the cedent and the reinsurer will tout different portions of the decision to support their respective positions. In *USF&G*, the policyholder agreed to release its claims under a number of primary policies. But when it came time to allocate and bill its reinsurers, the cedent allocated all of the payments to only one of those primary policies based on its understanding of the policies and how they worked. The reinsurers objected to this allocation, arguing that it was designed to maximize reinsurance recovery. The court disagreed, essentially finding that the allocation was reasonable. *USF&G*, 985 N.E.2d at 886 ("We see no evidence, however, from which a factfinder could infer that this aspect of USF&G's allocation was unreasonable.") A cedent may attempt to rely on *USF&G* to argue that: a) what transpired during settlement negotiations between the cedent and policyholder and b) the terms of the settlement agreement, do not dictate and can be divorced from the cedent's allocation determination. *Id*.at 883 ("consistency with the allocation used in settling the underlying claim does not by itself establish reasonableness.")

A reinsurer could respond to a cedent's reliance on *USF&G* as a basis to allocate inconsistently with its settlement by reiterating that deference to post-settlement allocations is derivative of FTS, not FTF, as provided in that very case. *Id*. at 881 ("A follow the settlements clause does require deference to a cedent's decisions on allocation.") Thus, deference to an allocation cannot be required where FTS does not apply.

Nonetheless, misapplication of these concepts can be seized upon by cedents to support reinsurance billings that are inconsistent with an underlying settlement. While the New York Court of Appeals did not require consistency between the settlement and a reinsurance billing, no court to our knowledge has sustained an allocation which it found to be inconsistent with the settlement upon which it is based.

Now, assume a cedent settles a claim with its insured on a basis that is not consistent with the cedent's own interpretation of its policy coverage, but bills its reinsurers on the basis that it had not settled with its insured. To support its billing, the cedent contends that it is relying on FTF to bind the reinsurer to its interpretation of the coverage provided by its policy, and is not asking the reinsurer to FTS. Thus, it asks the court to find its allocation to be "objectively reasonable" because it is based upon the cedent's good faith and reasonable interpretation of its policy obligation – even though those obligations have been compromised and mitigated by the settlement. The cedent, in essence, is attempting to expand application of the "objective reasonableness" test, adopted for the allocation process flowing from a settlement, to circumstances where the traditional FTF standard would apply. While an arbitration panel should have no problem recognizing that FTF, rather than FTS, is being invoked solely to enhance a reinsurance recovery,[7] a court may nonetheless be willing to support the billing if it could have been the product of arm's length negotiations if the reinsurance did not exist. *USF&G*, 985 N.E.2d at 882-883.

CONCLUSION

In the imprecise world of FTF/FTS, there is at least one sure thing: cedents and reinsurers alike will continue to look for creative ways to capitalize on the edges of the so-called doctrines. Even while the courts in recent years have added some clarity to certain issues (*e.g.*, whether and in which circumstances to imply following concepts into reinsurance contracts), other issues seem to have become even murkier (*e.g.*, whether an allocation falls within the FTF rubric, as opposed to solely a FTS one). The party that most effectively parses through and distinguishes the relevant case law places itself in prime position to frame the contours of the doctrines to its advantage.

Similar to how the data revolution and technology advances in baseball have led to tweaking of the fastball, cedents and reinsurers have to be ready to adapt to any subtle changes in FTF/FTS and its application.

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[1] *See* Charles W. Havens, III, *Recent Developments on the "Follow the Fortunes" Clause*, *in Reinsurance Litigation 1994*: *Current Issues and Strategies* at 27, 35-36 (PLI Com. Law and Practice Course Handbook Series No. 695, 1994)("Where a **judgment has been entered against the reinsured**, and the judgment is for risks covered under the reinsurance agreement, there is little room for the reinsurer to deny indemnification of the reinsured up to the stated policy limits, absent a lack of good faith in defending the action."); 13A John A. Appleman & Jean Appleman, *Insurance Law and Practice* § 7698 (1976) ("The reinsurer is generally bound by the **judgment** against the reinsured…."); *North River Ins. Co. v. CIGNA Reins. Co.*, 52 F.3d 1194, 1204-1206 ("*North River/Cigna*")(observing that FTF "forecloses

relitigation of **coverage disputes**" and precludes reinsurer from "revisit[ing] **coverage issues** resolved between the insurer and its insured")(emphasis supplied).

[2] That said, it is universally accepted by industry professionals and courts alike that FTF does not apply where the reinsurance billing relates to a loss or expense that is clearly outside of the scope of coverage provided by the reinsured policy.

[3] In its summary judgment ruling, the Court observed that Utica had "not argued that a follow-the-settlement clause should be implied based upon industry custom and practice." *Utica/Munich Re*, 2018 WL 1737623 at *68.

[4] The relevant certificate provision provided that Munich Re agreed to indemnify Utica for losses or damages that Utica "is legally obligated to pay under the policy reinsured".

[5] *See also*, *Travelers Cas. & Sur. Co. v. Gerling Global Reins. Corp. of Am.*, 419 F.3d 181 (2d Cir. 2005)(using the term "follow the fortunes" in the context of analyzing whether a reinsurer must follow a cedent's post-settlement allocation); *United States Fid. & Guar. Co. v. American Re-Ins. Co.*, 985 N.E.2d 876, 880-881 (N.Y. 2013)("*USF&G*")(referring to "follow the fortunes" and "follow the settlements" as if they are synonymous and opting to use "follow the settlements" in the context of analyzing whether a reinsurer must follow a cedent's post-settlement allocation).

[6] The court stated that "objective reasonableness should ordinarily determine the validity of an allocation." Specifically, "[t]he reinsured's allocation must be one that the parties to the settlement of the underlying insurance claims might reasonably arrived at in arm's length negotiations if the reinsurance did not exist." 985 N.E.2d at 882.

[7] It may also refuse to apply the following concepts to allocation.

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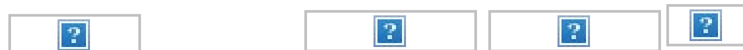

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