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Good-Faith Basis of Settlement Agreements Between Ceding Insurers and Insureds Is a Question of Fact

John D. LaBarbera • 312.382.3111 • jlabarbera@cozen.com
Nicole J. Moody • 312.382.3115 • nmoody@cozen.com

The "follow the fortunes" and "follow the settlements" doctrines often preclude reinsurers from re-examining the conduct of cedents in settling claims. However, a recent ruling by the Supreme Court of New York, Appellate Division, calls into question this conventional wisdom. In *American Home Assurance Co. v. Everest Reinsurance Co.*, 2011 N.Y. App. Div. LEXIS 9373 (Dec. 27, 2011), the court found that material issues of fact existed concerning whether the reinsurer would be required to indemnify the cedent for a settlement entered into with its insured due to subsequent favorable outcomes for the insurers in coverage litigation.

National Union Fire Insurance Company of Pittsburgh, Pa. (National Union) purchased reinsurance from Everest Reinsurance Company (Everest Re). In 1993, National Union settled the *Monsanto* coverage litigation involving claims for property damage caused by Monsanto's manufacturing of PCBs from 1929 to 1971 at 80 sites located throughout the United States (the 1993 Settlement). The 1993 Settlement agreement contained two components: (1) a single cash payment that resolved all existing and future governmental clean-up claims; and (2) an agreement as to the handling of all future bodily injury and property damage claims arising from PCB contamination. Just months after the 1993 Settlement, however, a Delaware Superior Court held that the sudden and accidental pollution exclusion barred coverage for Monsanto's exposures. *See Monsanto Co. v. Aetna Cas. & Sur. Co.,* 1993 WL 563253 (1993), *aff'd* 653 A.2d 305 (Sup. Ct. Del. 1994).

Several years after the 1993 Settlement and the Delaware court's ruling in the *Monsanto* coverage action, Monsanto was again subject to bodily injury and property damage claims arising from PCB contamination. The insured settled the underlying litigation for $600 million, and, pursuant to the 1993 Settlement agreement, sought coverage from National Union and its affiliates for $150 million. National Union paid this amount and sought reimbursement from its reinsurers. Everest Re denied the claim.

The Supreme Court of New York, Appellate Division, found that questions of fact existed as to whether there was a good faith basis for the 1993 Settlement. The court noted that, at the time of the 1993 Settlement, there was no evidence of bad faith on the part of National Union. However, the fact that shortly after the settlement the Delaware court found that the pollution exclusion barred coverage for the underlying claims raised an issue as to the good faith nature of the settlement. The panel also noted that Everest Re's claims representative attested that he had read the 1993 Settlement agreement by 2003, which also raised issues of fact as to the applicability of the doctrines of waiver and estoppel.

This decision is significant to reinsurers, as it holds that the good-faith basis of a settlement agreement between a ceding insurer and its insured may raise a question of fact to be determined by the trial court. Accordingly, reinsurers should be aware of subsequent coverage decisions that are favorable to their cedent insurers, as such decisions may raise viable defenses to reinsurance claims.

To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact:

John D. LaBarbera at jlabarbera@cozen.com or 312.382.3111
Nicole J. Moody at nmoody@cozen.com or 312.382.3115