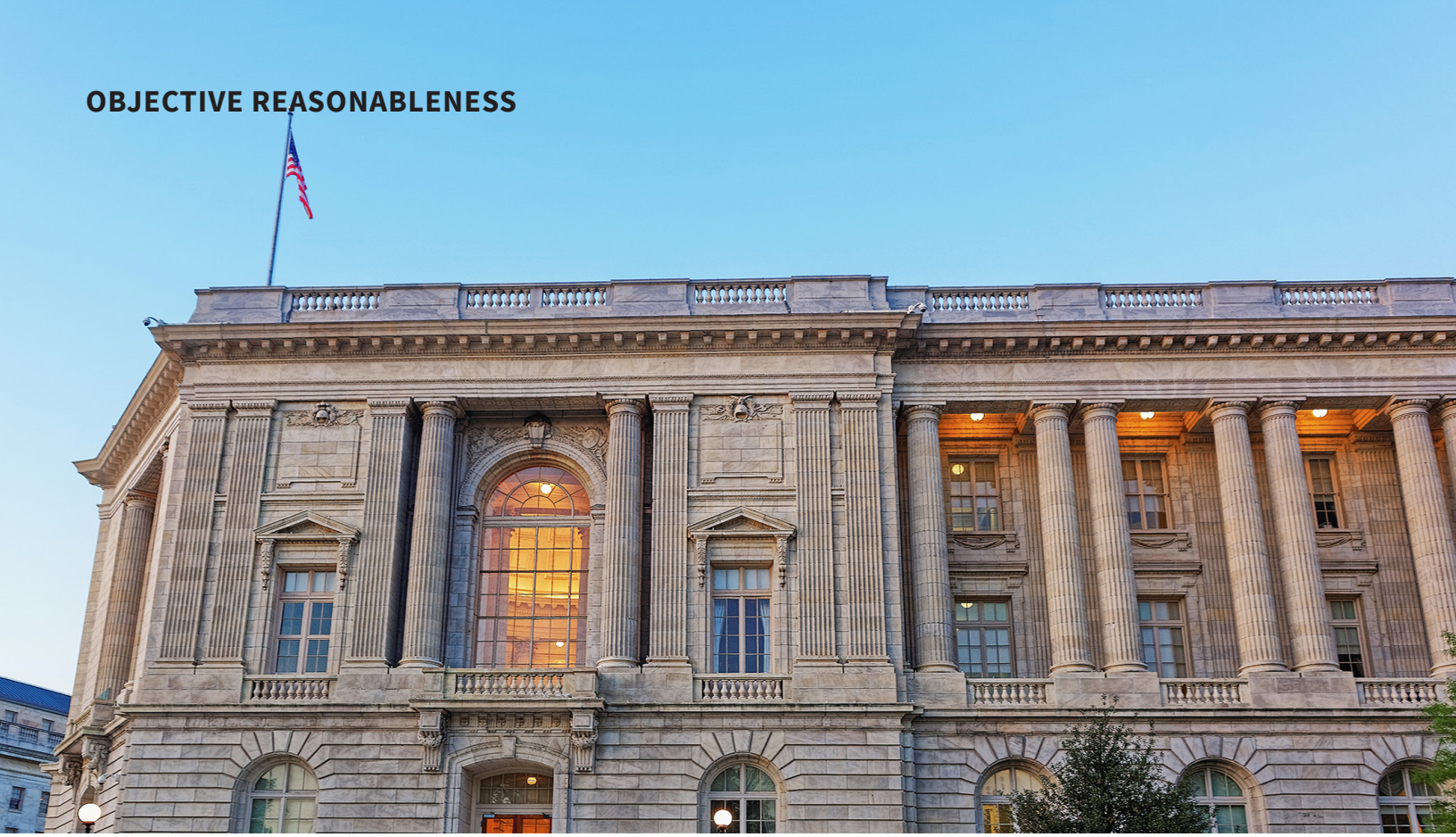

Assessing *USF&G's* 'Objective Reasonableness' Standard: An Alternative View

By Syed Ahmad and Patrick McDermott

It has been said before in these pages that we are "not ones to shy away from strong opinions." After reading "Assessing *USF&G's* 'Objective Reasonableness' Standard" in the 2020 Q1 issue of the *Quarterly*,[1] we are compelled to once again share those opinions in response to the overly pro-reinsurer interpretations of *USF&G* expressed by our friends at Rubin, Fiorella, Friedman & Mercante.

Decisions after *USF&G*

The authors paint a rosy picture for reinsurers looking for boundless discovery and seeking to overcome summary judgment. Yet, *USF&G* actually favors limiting discovery and further supports granting summary judgment.

Discovery. For discovery, *USF&G* and the cases following it have not broadened the scope of discovery or expanded the scope of inquiry, as the authors contend. If anything, *UF&G* narrowed the scope of discovery.[2] The court stated that "objective reasonableness should ordinarily determine the validity of an allocation" and "that the cedent's motive should generally be unimportant." Thus, because the allocation is judged from an objective standard, detailed discovery about the cedent's handling of a claim and its subjective views should generally be unnecessary.

Also, the two decisions cited in "Assessing *USF&G*" do not show that *UF&G* broadened discovery. Instead,

Excalibur simply rejects a cedent's attempt to use *USF&G* to limit discovery.[3] *Lexington* merely makes the unremarkable statement that the reinsurer was entitled to discovery under the follow-the-settlements doctrine.[4] Neither decision stated that discovery previously off limits to the reinsurer was now available because of *USF&G*.

Indeed, at least one arbitration panel has arrived at the opposite conclusion: that *USF&G* results in narrower discovery. In that dispute, between American Home and Wausau, American Home ceded the claim three separate times using three separate rationales.[5] The panel found that the third billing was reasonable. Despite that, Wausau argued that it still needed discovery as to whether American Home acted in good faith. The panel rejected that argument because it had found that American Home's allocation was reasonable, so Wausau had to pay the outstanding billings. That is, the panel prohibited discovery on the cedent's good faith because the governing standard was objective reasonableness.

Dispositive motions. As a corollary to the supposed expansion of discovery, the authors assert that courts will have difficulty ruling that a cedent's allocation is objectively reasonable as a matter of law because reinsurers are more likely to get sufficient discovery to show issues of fact. This should not be the case. In fact, where appropriate, courts and tribunals granted summary judgment to cedents before *USF&G* and should continue to do so after *UF&G*, particularly since they now need only consider objective reasonableness and generally need not consider subjective matters like motive. Inquiries about motive and the like can often raise more factual issues than an objective inquiry. *USF&G* itself supports courts continuing to grant summary judgment to cedents. In that case, the New York Court of Appeals found the cedent's allocation among the various insurance policies reasonable as a matter of law and upheld granting summary judgment to the cedent on that part of the allocation.

The pre-*USF&G* court rulings granting summary judgment include *Gerling v. Travelers*.[6] In that case, the district court had granted summary judgment to the reinsurer, Gerling. On appeal, the Second Circuit found Travelers's allocation reasonable as a matter of law, including based on the case law relevant to the challenged portion of the allocation. Thus, it directed the lower court to grant summary judgment to Travelers. The Second Circuit did so despite Gerling's arguments that Travelers had acted in bad faith because Gerling "failed to demonstrate anything approaching the requisite intent on the part of Travelers." That is, the court found summary judgment appropriate even where it considered the cedent's subjective bad faith to be a part of the analysis. Under *USF&G*, summary judgment would be even more appropriate given that "the cedent's motive should generally be unimportant."

In another case, *North River v. ACE,* the Second Circuit upheld the district court's decision to grant summary judgment to the cedent.[7] The reinsurer, ACE, had relied heavily on North River's pre-settlement analysis and claimed that North River's allocation of the settlement did not match its pre-settlement analysis. The Second Circuit rejected that argument, finding North River's allocation proper as a matter of law. In so doing, the court explained that a cedent "may engage in all manner of analyses to inform its decision as to whether, and at what amount, to settle, but those analyses are irrelevant to the contractual obligation of the reinsurer to indemnify the reinsured for loss under the reinsurance policy." That explanation is consistent with *USF&G's* later pronouncement that a cedent's motive is generally irrelevant.

The recent post-trial decision in *Utica v. Century* acknowledges that summary judgment rulings should be frequent in light of the governing standards.[8] In that case, Century challenged Utica's allocation, and a jury ruled in Utica's favor. Century filed a post-trial motion attacking Utica's allocation. In denying that motion, the court gave a detailed overview of *UF&G*. It then concluded that *USF&G* "recognizes that the follow-the-settlement doctrine sweeps broadly enough to permit the resolution of most reinsurance disputes at summary judgment."

Arbitration panels have also applied *USF&G* standards to issue dispositive awards in favor of cedents. As set forth above, the panel in the *American Home v. Wausau* dispute concluded that American Home's allocation was reasonable, found in favor of American Home, and denied Wausau's request for discovery on American Home's good faith. In a dispute between National Union and Resolute Re, the panel granted National Union's summary judgment motion, finding that its allocation was "objectively reasonable."[9]

Of course, there have been and will be decisions declining to grant summary

judgment, like those highlighted in "Assessing *USF&G*." There are plenty of decisions granting summary judgment, however, including those highlighted above from the Second Circuit, the New York Court of Appeals, and arbitration tribunals. Among those cases is *USF&G* itself, which undermines the idea that *USF&G* should lead to fewer summary judgment rulings.

Meeting the Objective Reasonableness Test

The authors also muse about the parameters of the New York Court of Appeals' "objective reasonableness" test set forth in *USF&G*. Many of their theories miss the mark.

For example, while recognizing the *USF&G* court's test is objective reasonableness, the authors try to work in a subjective component focused on the cedent's good faith. *USF&G* belies that attempt in multiple ways. The test is unequivocally "objective reasonableness" and does not have a subjective reasonableness component. Indeed, the court actually considered whether the cedent's subjective views should be relevant and decided they are not.

Thus, acknowledging the fact that *UF&G* "prohibits or severely restricts" a reinsurer's "ability to examine the cedent's motives for settling and allocating" is not a "pro-cedent view." It is decidedly the law in New York.

Manufactured Evidence and Self-Serving Testimony

The authors raise concerns that cedents can "manufacture evidence" and offer "self-serving testimony" to support allocations. This is a rather dim view of the world. That parties may disagree about what happened and why does not mean that evidence was "manufactured" or that testimony is "self-serving" in some nefarious way. Even if legitimate and accepted, however, this view is not unique to cedents, reinsurance cases, or an objective reasonableness standard. Every dispute (reinsurance or otherwise) can lend itself to characterizations that each side (cedents, reinsurers, or any other entity) "manufactured" evidence and provided self-serving testimony.[10]

For example, is it a coincidence that every time a reinsurer challenges an allocation, it construes the facts in a manner that would reduce its own liability and likely increase some other reinsurer's liability? Would it surprise anyone that a reinsurer's claims handler would testify that he or she never would have allocated in the manner in which the cedent did? To be clear, we are not faulting reinsurers solely because they may take positions that are in their own interest or for offering testimony that supports those positions. Rather, we are merely pointing out that a cynical view of purported problems of "manufacturing evidence" and "self-serving testimony" would apply to all participants, cedents and reinsurers alike.

Regardless, the answer is not to eliminate, change, or recharacterize legal tests and standards. There are other solutions already in place, like rigorous cross-examination. Indeed, the Utica claims attorney who offered purportedly "self-serving" testimony cited in the article was the subject of lengthy cross-examinations at three different trials. Two of those trials ended in a jury verdict in Utica's favor, and one case concluded—at least for now—with the court deciding the dispute based on legal issues not involving any evidence, much less any criticism about the testimony that the authors reference.[11] Moreover, the suggestion that the testimony offered under oath was false has no basis, and the accusation is contrary to other evidence.[12] All of that undermines the example the authors use to show the purported problem created by *USF&G*.

Relatedly, the authors' concerns about cedents retaining "hired guns" to opine in support of the cedents' decisions suffer from the same difficulties. If such problems exist, they would not be unique to reinsurance cases and would exist for cedents and reinsurers alike. Too often, one side's expert is the other party's "hired gun," and vice versa. Indeed, while portraying those opining on cedents' behalf as "hired guns," the authors suggest that reinsurers retain an "expert" to rebut those opinions.

No Separate Standard for Settlement Challenges

The authors suggest that a reinsurer can try to avoid the objective reasonableness standard by claiming it is challenging the cedent's settlement, not the cedent's allocation. Yet, while *USF&G* involved reinsurers challenging the cedent's allocation, nothing in that decision supports that a different standard would apply to challenges to a cedent's settlement. And, after *USF&G*, courts have applied the objective reasonableness standard to reinsurers' challenges to a settlement.[13] In addition, tribunals should reject reinsurers' attempts to obtain a different standard of review by cloaking a challenge to an allocation as a challenge to a settlement.

Consistency Between Allocation and Case Law

We do not quibble with the authors' expectation that "an allocation that is inconsistent with" a decision in the dispute between the cedent and the policyholder "is likely not objectively reasonable" except to clarify that it will always depend on the particular facts. But it is also true that an allocation consistent with court decisions on the relevant issues is likely objectively reasonable. Indeed, that was the basis for the *USF&G* court's ruling finding the cedent's allocation among insurance policies reasonable as a matter of law.

In conclusion, while the *USF&G* decision gives both cedents and reinsurers arguments to support and challenge cedent's decisions, it is not so pro-reinsurer as the authors in "Assessing *USF&G*" hope. Of course, time will tell, as courts will continue to interpret and apply decisions like *USF&G*.

NOTES

1 Eson, Jason, and Crystal Monahan. 2020. Assessing USF&G's 'Objective Reasonableness' Standard. *ARIAS Quarterly,* (1): 4-11.

2 *U.S. Fidelity & Guar. Co. v. American Re-Ins. Co.,* 20 N.Y.3d 407, 420-421 (2013).

3 *Travelers Indemn. Co. v. Excalibur Reins. Corp.,* No. 11-cv-1209, 2013 U.S. Dist. LEXIS 50134 (D. Conn. Apr. 8, 2013).

4 *Lexington Ins. Co. v. Sirius Am. Ins. Co.,* No. 651208/2012, 2014 N.Y. Misc. LEXIS 4138, at *26 (N.Y. Sup. Ct. Sept. 15, 2014) ("Sirius is entitled to discovery regarding National and Lexington's settlement and allocation decisions.").

5 *Am. Home Assur. Co. v. Employers Ins. Co. of Wausau,* No. 13-cv-5169, Dkt. 26-7 (S.D.N.Y.), available from authors upon request.

6 *Travelers Cas. & Sur. Co. v. Gerling Global Reins. Corp. of America,* 419 F.3d 181, 194 (2d Cir. 2005).

7 *North River Ins. Co. v. Ace American Reins. Co.,* 361 F.3d 134, 137 (2d Cir. 2004).

8 *Utica Mut. Ins. Co. v. Century Indemn. Co.,* 419 F. Supp. 3d 449, 464 (N.D.N.Y. 2019).

9 *National Casualty Co. v. Resolute Reins. Co.,* No. 15-cv-9440, Dkt. 9-1 (S.D.N.Y.), available from authors upon request.

10 See *U.S. v. Sklena,* 692 F.3d 725, 733 (7th Cir. 2012) ("The characterization of Sarvey's statements as 'self-serving' is also unhelpful. To say that evidence is 'self-serving' tells us practically nothing: a great deal of perfectly admissible testimony fits this description." (citation omitted)).

11 *Utica Mutual Ins. Co. v. Century Indemn. Co.,* 419 F. Supp. 3d 449, 464 (N.D.N.Y. 2019); *Utica Mutual Ins. Co. v. Munich Reins. America, Inc.,* 381 F.Supp.3d 185 (N.D.N.Y. Mar. 29, 2019), *Utica Mutual Ins. Co. v. Fireman's Fund Ins. Co.,* 287 F.Supp.3d 163 (N.D.N.Y. 2018), reversed on other grounds by 957 F.3d 337 (2d Cir. Apr. 28, 2020).

12 *Utica Mutual Ins. Co. v. Fireman's Fund Ins. Co.,* 287 F.Supp.3d 163, 171 (N.D.N.Y. 2018) ("Utica's position has remained that it was unaware of the FFIC reinsurance at the time it settled with Goulds."); *id.* at 169 ("Utica presented extensive evidence that its settlement decisions were reasonable"); *id.* at 170 ("Plaintiff presented evidence that Goulds' summaries of its own insurance program from the 1966 to 1972 period showed aggregate limits for products liability. Two of the primary policies from that time period showed an aggregate limit. Utica argued that in the absence of evidence that Goulds intended to change its insurance program, this "book end" proof provided evidence to Utica that the intervening policies had the same limits."); *id.* at 170 ("In sum, the results of Utica's investigation, Mr. Robinson's virtual policy project, and the final advice from Utica's outside counsel all confirmed to Utica that the 1966 to 1972 primary polices contained aggregate limits. Dennis Connolly, one of plaintiff's experts, opined that aggregate limits were standard in the 1960s and 70s and confirmed the reasonableness of Utica's position on same. Plaintiff also introduced evidence that Brian Gagan, one of FFIC's prior experts in the underlying litigation, agreed with that position.").

13 *Utica Mut. Ins. Co. v. Fireman's Fund Ins. Co.,* 6:09-cv-853, Dkt. 439 (N.D.N.Y. 2017) (jury instruction stating that "You are being asked to decide whether Utica Mutual's decision to settle with Goulds on the basis that its 1966 through 1972 primary policies contained aggregate limits was among the objectively reasonable options available."), available from authors upon request.

Syed Ahmad is a partner in Hunton Andrews Kurth LLP's Washington, D.C. office. He advises clients in connection with reinsurance disputes and matters involving direct insurance policies, including general liability policies, errors and omissions policies, directors and officers (D&O) policies, commercial property policies, and representations and warranty (R&W) insurance.

Patrick McDermott is a counsel in Hunton Andrews Kurth LLP's Richmond, Virginia office. He advises clients on all aspects of insurance and reinsurance coverage. He assists clients in obtaining appropriate coverage and represents clients in resolving disputes over coverage, including in litigation and arbitration.