



# COUGHLIN DUFFY LLP

CASE ALERT, NO. 5

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## DISTRICT COURT HOLDS REINSURER NOT BOUND BY "FOLLOW THE SETTLEMENTS" DOCTRINE



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On July 14, 2006, Judge William G. Bassler of the United States District Court for the District of New Jersey rendered a reinsurance decision of note in the case of Karen L. Suter v. General Accident Insurance Company. Following a non-jury trial, Judge Bassler issued a lengthy Opinion with extensive findings of fact, holding that General Accident was not bound by the "follow the settlements" doctrine to cover settlements entered into by its cedent Integrity Insurance Company with respect to products liability claims tendered by Integrity's insured Pfizer, Inc. ("Pfizer"). Judge Bassler's opinion is significant in defining the limits of the "follow the settlements" doctrine, at least as applied by one District Court.

The genesis of this reinsurance action is the manufacture and sale by Pfizer of the Shiley heart valve. Faced with numerous lawsuits alleging malfunction or fear of malfunction of the heart valves, Pfizer settled a large class action in 1992, agreeing to pay hundreds of millions of dollars on account of claims by valve recipients whose valves had not failed, but who claimed to suffer anxiety about the prospect that they would fail.

Pfizer purchased liability insurance as part of a layered program with total occurrence and aggregate limits exceed \$100 million from October 1978 through October 1985. Integrity was an excess carrier in each of those policy years. Integrity's 1982 and 1983 policies provided coverage of \$3 million per occurrence and in the aggregate as part of a \$40 million layer, attaching above \$65 million of underlying primary insurance, in excess of a \$10 million SIR. Integrity's 1982 and 1983 policies followed form to umbrella liability policies issued by Transit which, in turn followed form to two primary policies issued by the Insur-

ance Company of North America to Pfizer. Under the Transit policies and the Integrity follow-form policies, coverage was not triggered unless personal injury or property damage, caused by an occurrence, took place during the policy period. General Accident issued facultative reinsurance to Integrity on a pro-rata basis. The stated reinsurance limit for each policy was \$2 million part of the \$3 million limit of both Integrity policies.

Pfizer pursued coverage for the Shiley valve claims from Integrity in early 1999. Integrity ultimately paid the limits of its 1982 and 1983 policies, using as a trigger date the date of implant of the heart valves. Integrity paid the claims where the date of implant of the valve had occurred during its policy periods. Subsequently, Integrity looked to General Accident for payment under the facultative contracts and claimed that the doctrine of "follow the settlements" applied. General Accident refused payment, contending that Integrity did not act reasonably or in good faith in providing coverage for the heart valve claims where there was no proof of bodily injury during the policy period. General Accident argued that the "follow the settlements" doctrine did not apply where a cedent did not take all proper and businesslike steps in investigating the claim.

While recognizing that the "follow the settlements" doctrine binds a reinsurer to accept the cedent's good faith decisions on settlement, Judge Bassler noted that the cedent is required to make a good faith and reasonable business like investigation. Judge Bassler held that, under the facts of the case, the reinsurer had met the "high burden" to prove bad faith in the adjustment of the claim by the cedent and that the payments made were clearly beyond the scope of the reinsured policy.

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The Court found that Integrity provided coverage to Pfizer without any independent investigation of the matter, and in fact simply accepted Pfizer's position regarding trigger (at the time of implant) without any medical evidence to support it, without consulting any expert medical advice, and ignoring applicable precedent. Judge Bassler held that Integrity had no proof that any bodily injury had occurred during its policy periods at the time it settled the claims with Pfizer, and accordingly General Accident was not required to cover the settlements under the reinsurance contract.

Judge Bassler stated that his determination was not a question of "second-guessing" Integrity's decision:

When it comes to reinsurance, a good faith decision is not subject to de novo review. But Integrity did have a duty to General Accident as its reinsurer to independently investigate the claim and make a reasonable determination as to whether the heart valve claims should be allowed. ... [Integrity's] efforts didn't satisfy that duty.

Judge Bassler's ruling is instructive as an example of the unusual case where a Court declines to require a reinsurer to "follow the settlement". It remains to be seen whether the Court of Appeals will share Judge Bassler's belief that Integrity's claims handling and settlement decision fell outside the ambit of the doctrine. Regardless of the result on appeal, this trial court ruling stands as evidence that the "follow the settlements" doctrine is not without limit.

Should you have any questions with respect to this decision, please do not hesitate to contact us.