

# Insurance Law Advisor

A Newsletter by Budd Larner Rosenbaum Greenberg & Sade, P.C.

## Wellington and Reinsurance: A Continuing Problem?

By Marc I. Bressman, Esq.

It has been 18 years since a significant number of asbestos manufacturers and suppliers (*i.e.*, "producers"), and their insurers (chart A), executed the Agreement Concerning Asbestos-Related Claims, commonly known as the "Wellington Agreement". Despite the radical nature of the Agreement, its effects upon reinsurance recovery, at least as revealed in reported case law, have been rather sparse.

The asbestos problem does not seem to be ending. In fact, it seems to be getting worse. In an article published in 2001, Michael E. Angelina, an actuary with Tellinghast-Towers Perrin, noted that past solutions for the problem, such as the Manville Trust, the Asbestos Claims Facility ("ACF"), and the Owens Corning National Settlement Program, appear not to have worked, and claim counts have actually increased.

In a Rand study published in August, 2001, the authors reported varying predictions of the number of claims yet to be filed: from 500,000 to 2.5 million. In its 10-K filed December 31, 2002, Pfizer, Inc., a very peripheral player in the asbestos industry, reported approximately 128,000 pending claims against it and its wholly owned subsidiary, Quigley.

In a recent article in The New York Times, the author reported on negotiations for a federal asbestos trust, which would be expected to pay out in excess



of \$100 billion.

Chart B, an insert to this article, is a summary of the key provisions of the Wellington Agreement. This article will first review those few reported decisions which have dealt with Wellington-related issues, and then discuss those issues which could yet lead to reinsurance recovery difficulties. It is certainly possible, indeed probable, that some of these issues may have already played a role in confidential reinsurance arbitrations, but decisions in those arbitrations provide neither guidance nor precedent to the rest of the industry.

### Precedential Authority

### Voluntary Payments

There is sparse reported case law on Wellington issues in a reinsurance context. The first reported case, *Hiscox v. Outhwaite*, which upheld a reinsurer's refusal to reimburse for "voluntary" payments made under Wellington on behalf of

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Despite the radical nature of the Wellington Agreement, its effects upon reinsurance recovery raise more questions than answers. Cedents and their reinsurers will continue to face issues with regard to following the settlement, and whether and to what extent exceptions exist.

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non-insureds, led to a decision by the Center for Claims Resolution (“CCR”) to modify its allocation methodology, so that only producers who were actually named in the complaint contributed (or their insurers contributed) to the settlement or judgment. Previously, all CCR (and ACF) signatories contributed to all settlements, and judgments.

### Notice Issues

In *Unigard Security Ins. Co. v. North River Ins. Co.*, Unigard, the reinsurer, claimed that it was excused from payment because the cedent, North River, had signed the Wellington Agreement without providing notice to Unigard of its intent to do so. The District Court held that since North River’s payments on behalf of its insured, Owens-Corning (OCF), were made after OCF withdrew from the ACF, they were not affected by Wellington, and therefore Unigard was not prejudiced by the late notice.

On appeal, the Second Circuit first certified the question of whether a reinsurer must prove prejudice to prevail on a late notice defense to New York’s Court of Appeals, which ruled in the affirmative.

Thereafter, the Second Circuit held that the District Court incorrectly ruled that North River’s payments were not affected by Wellington. The Court pointed out that the Wellington Agreement was perpetual, and therefore its rules “were used to compute which insurance companies would pay and how much they would pay for each claim.” Furthermore, since some of the ceded payments were for claims settled by the ACF prior to OCF’s withdrawal, and since Wellington provided that the ACF had the “exclusive” authority to settle its members’ claims, Unigard lost its right to associate in the defense and settlement of those claims.

The Second Circuit found, therefore, that Unigard was entitled to notice of signing of the Wellington Agreement. But, since Unigard conceded that it could not show an economic loss because of North River’s failure to give timely notice, the Court required Unigard to pay the reinsurance.

### Scheduling

Unigard was not the only reinsurer to give North River a difficult time over Wellington. In *North River Ins. Co. v. Cigna Re*, Cigna Re, the reinsurer, refused payment of defense costs in addition to limits because of North River’s failure to comply with the coverage scheduling requirements of Appendix D of the Wellington Agreement. The Third Circuit found for the cedent, holding that its failure to properly schedule its allegedly “cost-exclusive” policy was irrelevant, since the court decided the policy was “cost in addition” anyway, wholly apart from the cedent’s failure to object to the insured’s having scheduled the policy as one which required the insurer to pay costs in addition to limits. A more complete analysis of this case, or of *Unigard v. North River*, is unnecessary here, both cases having been discussed at length in numerous articles.

What is important, however, is a review of what the two cases held, and did not hold, with respect to Wellington and reinsurance recovery, and what other issues are yet to be decided. Unigard held that the Wellington Agreement had a sufficient effect upon the liability of the ceding company such that notice was required. According to the Court, the effect upon the reinsured’s liability because of the allocation formulas, and the loss of the reinsurer’s right to associate, required a ceding company to provide notice to its reinsurers.



The Wellington Agreement had a sufficient effect upon the liability of the ceding company such that notice was required

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In *North River*, the reinsurer apparently never argued that the cedent's execution of Wellington substantially altered the terms of its reinsurance certificate. Had Cigna Re done so, we might have a definitive answer as to whether a cedent who, without notice to its reinsurers, executes Wellington, loses its rights to recover under its facultative certificates.

The Second Circuit, in *Unigard*, held that an alteration of coverage took place without notice, but economic prejudice was not proven. The Third Circuit, in *North River*, did not have to decide the issue. Both courts, however, spoke favorably toward the Wellington Agreement, and therefore, absent other unusual circumstances, it is probable that a reinsured would not be adversely affected because it signed Wellington without notice to its reinsurers. It is interesting to speculate, of course, on what the outcome would have been in *North River* if the court had decided that the policy at issue actually had no expense requirement. Would the cedent's error in scheduling a "cost exclusive" policy as a "cost in addition" policy have been viewed by the court as *ex gratia*?

With the recent demise of the CCR, the organization which in 1988 replaced the ACF as the claims handling organization, the issue of the right to associate in the defense becomes of less importance, although it probably was never a genuine issue in any case.

Insureds are now handling their own claims, and therefore not contributing by predetermined formula with other Wellington signatories. But signatories are still required to allocate liabilities under the Wellington allocation formula to their insurers who are also Wellington signatories. In addition, as evidenced by the complaint filed in the so-called "shortfall" litigation, it ap-

pears that a large group of non-signatory insurers entered into settlement agreements with Wellington producers whereby those insurers agreed to fund asbestos-related bodily injury claims, by utilizing a "Wellington-type" allocation formula.

### As Yet Undecided Issues

#### *Ex Gratia* Issues

The shortfall litigation itself raises an issue with potentially serious effects upon reinsurance recovery. The complaint seeks to recover from the defendant insurers those amounts which the remaining solvent producers may have to pay, or have already paid, to cover shortfalls in settlements made by the CCR, on behalf of its members, resulting from the bankruptcies of Armstrong World Industries, GAF, APMC, U.S. Gypsum and others.

Insurers are being asked to contribute amounts, in addition to those amounts already paid on behalf of their insureds, to cover the default of parties they did not insure. The sharing formula, where an insurer is required to pay for some non-insured's liabilities, discussed in *Hiscox v. Outhwaite*, once again becomes an issue.

If a shortfall defendant insurer settles, and agrees to cover a shortfall amount, will that be viewed as an *ex gratia* payment by its reinsurers, who will argue, as the reinsurer did in *Hiscox v. Outhwaite*, that they never agreed to reinsure a non-insured's liability? But, is it truly *ex gratia* if the original settlement agreement between the claimants' counsel and the CCR provides for joint and several liability, or is judicially determined to provide for joint and several liability, and therefore the insurer is paying liability imposed on its insured by law, rather than as a "volunteer" for another insured's liability?

Will an agreement to cover a shortfall payment be viewed by reinsurers as an *ex gratia* payment?



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Can “re-settlement” by the remaining solvent CCR members be viewed merely as a reallocation of their liability, and therefore required to be paid by their insurers who previously agreed to abide by the sharing formulas among producers pursuant to Section V.2 of Wellington? Is there a difference between “routine” adjustments to the producer sharing formula based upon shifting membership in the ACF or CCR, or being named (or not named) in a complaint, and an adjustment based on solvency of the members? Unless there is, reinsurers will be unable to successfully raise the *ex gratia* defense.

Related to the above is the issue of a Wellington signatory insurer, who, pursuant to Section X of the Agreement, pays in lieu of non-signatory and/or insolvent insurers. Are such payments *ex gratia*?

### **Aggregate Issues**

As noted above, Section XVIII of the Wellington Agreement mandates that policies issued for a period of less than 12 months (so-called “stub policies”), “carry full aggregate limits for the term” of the policy. If an insurer executes the Wellington Agreement, does that bind its reinsurers to coverage which was not previously intended to be reinsured? Or are stub policies routinely interpreted as carrying full limits in any case?

Insurers who issued policies without aggregates on their premises and operations coverages (so-called non-products coverage), and that probably includes most policies until just recently, receive a significant benefit from Section XVIII of Wellington, an imputed aggregate on those limits. That is clearly a benefit to cedents and their reinsurers.

But what about a non-signatory

insurer which sits directly above a primary insurer with a Wellington-imputed aggregate, where the insured has significant non-products exposure? The non-signatory insurer, and its reinsurers, discover that the “protection” afforded by the circumstance that individual non-products claims ordinarily never reach the occurrence limit, and therefore the primary never exhausts, no longer exists as a result of the imputed aggregate provided by Wellington to the underlying coverage.

Will the excess carrier face difficulties in recovering from its reinsurers, who may claim that the reinsured liability has been drastically altered by the primary insurer’s acquisition of aggregate protection through Wellington? Since the ceding company certainly cannot, and could not ever, interfere with an agreement between its insured and its primary carrier to impute aggregate, to which it was not privy, there does not seem to be much the reinsurers can do either.

### **Occurrence Issues**

A related issue is the number of occurrences. The Court in *International Surplus Lines Ins. Co. v. Certain Underwriters*, 886 F. Supp. 917, 922-23 (S.D. Oh. 1994), was only technically correct when it stated that Wellington did not directly affect the issue of the number of occurrences, since there is no language in Wellington which directly addresses this issue.

The manner in which Wellington operates, however, treats every claim as a separate occurrence. With respect to products claims, the aggregate products limits are reduced by each allocation for each settled claim. Of course, the result would be the same even if the insured’s asbestos liability was treated as one occurrence, or just a few occurrences.



The manner in which Wellington operates treats every claim as a separate occurrence

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In each case, the aggregate provisions applicable to products coverage would cap payment at the aggregate limit.

What about the situation where the insured producer has non-products liability, either arising from its activities as an installer of its own or another manufacturer's asbestos-containing materials, or as the owner of premises potentially liable to non-employees who become exposed to asbestos while on the insured's premises?

The Wellington Agreement contemplates non-products claims, but does not identify or distinguish how they are to be handled. All asbestos bodily injury claims, whether arising from products or non-products exposure, trigger allocation first to the producer, and then to the insurer. The insurers' products coverage aggregate limit, scheduled on Appendix D, is eroded and exhausted without any guidance in the Agreement as to what claims, or what percentage of payments, are to be allocated to the non-products coverage which is also scheduled in Appendix D.

From 1985, and at least until the recent demise of the CCR, all claims payments were allocated to the insurers' products aggregate limits, exhausting them; upper layers then attached, and were themselves exhausted, until all of the products coverage was exhausted. The non-products coverage was left intact, unless the insured and its insurers made a side deal to charge some of the claims payments to non-products coverage.

Section XVII of the Wellington Agreement imputes an aggregate for the non-products liability coverage in primary and first layer excess policies. As explained above, this non-products aggregate is scheduled separately in Appendix D. The obvious implication therefore is that, as to both products

and non-products claims, each claim is a separate occurrence, and both the actual and the imputed aggregates operate to permit exhaustion. There would be no need for imputed aggregates if all of an insured's asbestos liability is treated as one occurrence.

Wellington therefore operates to treat each claim as a separate occurrence, with two separate aggregate limits, the actual aggregate limit for products claims, and an imputed aggregate limit for non-products claims. This may not be inappropriate, since we are dealing with two separate coverages, products and non-products. Whether reinsurers thought they would pay two occurrence limits, one for products, and another for non-products, is another unanswered question.

### **Conclusion**

Whether or not the new Federal legislation is enacted, it seems clear that insurers are going to be continuing to pay significant dollars to cover their insured's asbestos liabilities. Where those insurers are Wellington signatories, or have agreed to pay on a Wellington basis with insureds who are Wellington signatories, cedents and their reinsurers will continue to face issues with regard to "follow the Wellington settlement", and whether and to what extent exceptions exist.

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### CHART A

#### Producer Members

A.P. Green (late signatory); Armstrong World Industries, Inc.; Fibreboard Corporation; ACandS, Inc.; Carey Canada Inc.; The Celotex Corporation; CertainTeed Corporation; Eagle-Picher Industries, Inc.; Flexitallic Gasket Company, Inc.; The Flintkote Company; GAF (late signatory); Keene Corporation; Maremont Corporation; National Gypsum Company; National Service Industries, Inc., d/b/a North Bros.; Nosroc Corp.; Nuturn Corporation; Owens-Corning Fiberglas Corporation; Owens-Illinois, Inc.; Pfizer, Inc.; Pittsburgh Corning Corporation; Porter Hayden (late signatory); H.K. Porter Company, Inc.; Quigley Company, Inc.; Shook & Fletcher Insulation Company; Thorpe Insulation Company; C.E. Thurston & Sons, Inc.; Turner & Newall PLC; Unijax, Inc.; United States Gypsum Company; and Union Carbide.

#### Insurer Members

Aetna Life & Casualty Company; CIGNA Property and Casualty Insurance Companies; The Continental Insurance Company; Lloyd's Underwriters and Certain London Companies; Bituminous Casualty Corporation; Crum & Forster Corporation; Employers Insurance of Wausau; Fireman's Fund Insurance Company; Hartford Insurance Group; Reliance Insurance Company; Royal Insurance Company; American Universal Insurance Company; and Zurich-American Insurance.

Marc I. Bressman, Esq. is the managing shareholder in Budd Larner Rosenbaum Greenberg & Sade, P.C.'s Cherry Hill, NJ office. He concentrates his practice on reinsurance and insurance claims and coverage matters; professional liability claims; and defense of general tort litigation.

### *Budd Larner Rosenbaum Greenberg & Sade, P.C.*

150 John F. Kennedy Parkway  
Short Hills, NJ 07078-0999

tele 973.379.4800  
fax 973.379.7734  
e-mail: info@budd-larner.com

Visit us on the Web:

[www.buddlarner.com](http://www.buddlarner.com)

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