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Massachusetts Federal Court Finds “Follow the Fortunes” Implicitly Included in Retrocessional Agreement

In the realm of reinsurance law, a key concept explicitly built into most retrocessional agreements is the “follow the fortunes” doctrine. Under this doctrine, a reinsurer must follow the fortunes of its cedent absent evidence of fraud, collusion or bad faith. The doctrine provides that a reinsurer is bound by the cedent’s claim settlement decisions, an obligation which extends to a cedent’s good faith decision to waive defenses to which it may have been entitled. The core purpose of this doctrine is to preclude relitigation of coverage disputes while providing a stable context for cedents to make claims-handling decisions. Although Massachusetts federal courts previously addressed the scope of this doctrine in instances

where parties incorporated a specific contractual clause regarding “follow the fortunes”, a recent decision addressed whether the doctrine may still apply in the absence of such a clause. The United States District Court for the District of Massachusetts held that the doctrine of “follow the fortunes” can be implied in a retrocessional agreement although never formalized by an express clause in a written agreement.

Issues arising out of “Compcare 2000”:

In *Trenwick American Reinsurance Corp., v. IRC, Inc.*, Trenwick, the reinsurer, claimed that it was owed unpaid losses by IRC Re, Limited, a co-defendant and the retrocessionaire, pursuant to an agreement which was never fully formalized by written contract. The agreement between the parties revolved around a managed workers’ compensation insurance and employer’s liability insurance program entitled “Compcare 2000.” The Plaintiffs claimed that IRC Re, Limited breached a reinsurance contract under which IRC Re, Limited was to provide retrocessional coverage for the “Compcare 2000” program.

Some of the unpaid losses at issue were resolved by Trenwick during arbitration proceedings between Trenwick and the direct insurer, Reliance National Insurance Company. When the Defendants argued that they could relitigate


the defenses Trenwick put forth in its arbitration with Reliance before settlement of the case at bar, Trenwick countered that the “follow the fortunes” doctrine barred them from doing so.

No formally expressed “Follow the Fortunes” clause in Retrocessional Agreement:

Although the retrocessional agreement contained no express “follow the fortunes” clause, Trenwick argued that the doctrine is “inherent in every reinsurance relationship,” and should be implied as a matter of law. The court disagreed, but allowed expert testimony on industry custom and usage to guide its decision relative to whether or not this principle could be incorporated. The court noted that although such a doctrine is not implied by law, expert testimony regarding industry custom and usage can empower the court to apply the “follow the fortunes” doctrine in the absence of an explicit contractual clause.

The Plaintiffs’ expert testified that all of the other written contracts between the parties relative to “Compcare 2000” had “follow the fortunes” language. He testified that “without ‘follow the fortunes’ the risk transfer mechanism of a reinsurance program would not work.” The Defendants’ expert even noted that it would be “extraordinarily unusual” not to see a “follow the fortunes” clause in the retrocessional contract between these parties. Based on this expert testimony regarding custom and usage of the reinsurance industry, the court held that the doctrine of “follow the fortunes” was implied in the agreement at issue, even in the absence of an express contractual clause.

Impact Going Forward:

This decision highlights the distinct importance of industry practice and conduct when interpreting reinsurance agreements. Although a “follow the fortunes” clause cannot be implied as a matter of law, effective expert testimony of industry customs and practice may well allow a court to infer such a clause. 

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SJC Continues Trend of Expanding Duties Owed by Commercial Landlords

Historically, Massachusetts courts have limited the applicability of many state statutes that regulate lease agreements to residential tenancies. However, the Massachusetts Supreme Judicial Court has started to apply such statutes to commercial leases. In *Bishop v. TES Realty Trust*, the Massachusetts Supreme Judicial Court held that a statute requiring landlords to remedy unsafe conditions on the premises after notice, even if the lease states otherwise, applies to commercial as well as residential leases.

Application of M.G.L. c. 186, § 19 previously limited to residential lease context:

Mary Bishop leased commercial space from the defendant landlord to operate a tanning salon. In June 2000, Bishop sent a certified letter to the landlord complaining about a leaking roof. More than a year later, the landlord partially repaired the roof. Nine months after that, Bishop injured herself while placing a bucket in an effort to control the remaining leaks.

Bishop filed suit against her landlord and the case proceeded to trial. The trial judge allowed the landlord's motion for directed verdict, ruling that TES Realty Trust did not owe its tenant a common law duty to repair the unsafe condition. The judge also determined that the defendant owed no statutory duty to repair the leaks because M.G.L. c. 186, § 19, which mandates that a landlord exercise reasonable care to correct an unsafe condition described in a written notice from a tenant, did not apply to commercial leases. The tenant appealed the adverse ruling and the SJC transferred the appeal for its consideration.

SJC extends application of statute to commercial leases:


In a case of first impression, the Court determined that the statutory duty of a landlord

under M.G.L. c. 186, § 19 applied to both residential and commercial leases. Under M.G.L. c. 186, § 19, after receiving the required notice of an unsafe condition, not caused by the tenant, in a portion of the premises controlled by the tenant, a landlord owes a duty to exercise reasonable care to remedy the unsafe condition. Further, § 19 dictates that a landlord may not obtain a waiver of this duty in any lease or rental agreement; any such waiver will be held void and unenforceable.

In reaching its decision, the Court examined the statute's plain language, concluding that there was nothing in § 19 to suggest that it applied only to residential leases. The court noted that "[w]hen the Legislature has intended to distinguish between residential and commercial leases, it has included specific language to that effect." The Court then turned to the statute's legislative history to further support its decision. The Court found it compelling that, when drafting the statute, the Legislature rejected a proposed precursor to § 19 that exempted commercial landlords from the aforementioned statutory duty. The Court reasoned that this revision suggests that the Legislature considered, and rejected, limiting § 19 to residential landlords.

Impact going forward:

By mandating that commercial leases comply with M.G.L. c. 186, § 19, the SJC expanded the scope of commercial landlord liability for unsafe conditions in areas controlled by the tenant. Further, commercial lease clauses that attempt to immunize a landlord from liability for damages stemming from an unsafe condition, not caused by the tenant, in an area controlled by the tenant, are likely to be found void and unenforceable.

When viewed in conjunction with the 2010 decision of *Norfolk & Dedham Mut. Fire Ins. Co. v. Morrison*, in which the SJC ruled that the statute providing that any contractual language attempting to require a tenant to indemnify a landlord for the landlord's own negligence would be void was equally applicable to commercial leases, the decision in *Bishop* suggests a trend of the SJC applying statutes to commercial leases that were customarily limited to the residential tenancy context. 

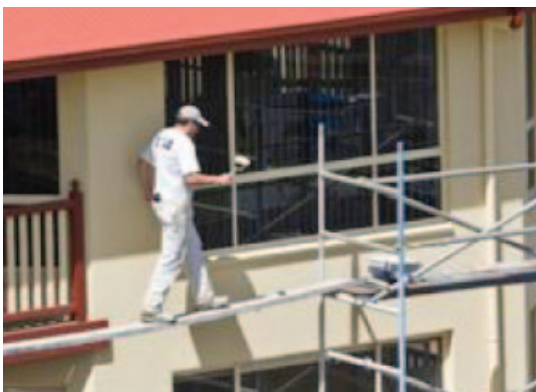
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“When the Legislature has intended to distinguish between residential and commercial leases, it has included specific language to that effect.”



General Contractors Not Entitled to Immunity When they Pay Workers' Compensation Benefits to Employees of Uninsured Subcontractors

All employers are required to provide workers' compensation insurance for the benefit of their employees. As recently noted by the Massachusetts Supreme Judicial Court, this requirement has been extended in the realm of the construction industry "[t]o prevent ... [an insured entity such as a general contractor] from escaping the obligation of the Compensation Act by letting out part of [its] work to irresponsible subcontractors or independent contractors." To that end, the Massachusetts Workers' Compensation Act requires that the insurance carrier for the general contractor pay benefits to an injured employee of an uninsured subcontractor.



Another significant aspect of Massachusetts' statutory workers' compensation scheme is that an employer who pays benefits is generally immune from any ensuing common law personal injury claim by the employee.

These two tenets clashed in *Wentworth v. Henry C. Becker Custom Building Ltd.*, where the SJC held that general contractors are not entitled to workers' compensation immunity even if they pay benefits to the employee of an uninsured subcontractor.

An Explosive Claim:

As part of a 2005 residential construction project, general contractor Henry C. Becker Custom Building Ltd. subcontracted with Great Green Barrier Co. to perform waterproofing work. An explosion at the job site resulted in the death of Timothy Wentworth and serious injuries to his son, Ezekiel Wentworth, both employees of Great Green. Great Green did not have workers' compensation coverage for its employees and Becker did nothing to confirm whether or not such coverage was in place.

The accident resulted in workers' compensation claims filed with the Department of Industrial

Accidents. The claims were eventually resolved by means of lump sum settlements in which Becker's workers' compensation insurer paid benefits. While the workers' compensation claims were pending, the Wentworths commenced a wrongful death and personal injury action alleging "negligence, gross negligence and/or willful, wanton or reckless conduct" by Becker.


Becker successfully moved for summary judgment arguing that it was entitled to workers' compensation immunity, giving rise to the appeal that was then granted further appellate review by the SJC. The general contractor relied primarily upon that section of the Massachusetts Workers' Compensation Act that provides immunity to a qualifying "insured," defined to mean an employer who provides workers' compensation insurance to "his employees."

Policy-Driven Reversal on Technical Grounds:

Noting that Massachusetts Courts "construe broadly the Workers' Compensation Act for the protection of injured workers," the SJC ruled that immunity under the act applies to "the insured," but that a general contractor like Becker cannot qualify as an "insured" because the term is limited to employers providing coverage to **his employees**. Timothy and Ezekiel Wentworth were not Becker's employees.

Crediting the appellate court that originally reversed the motion judge's decision in 2010, the SJC agreed that "although the insurer of a general contractor that willfully or negligently hires an uninsured subcontractor is required to pay the uninsured subcontractor's compensation obligation, the contractor would obtain the benefit of being released from the significantly greater damages it likely would face in a common law action." Finding that the Legislature did not intend such a result, the SJC affirmed the summary judgment reversal and remanded the case for further proceedings in the trial court.

Impact Going Forward:

One stated goal of this decision is to give "a general contractor strong incentive to retain subcontractors who have workers' compensation insurance because it otherwise has to pay the workers' compensation benefits and is liable for any common law damages." Thus, general contractors and their liability insurers will likely take greater efforts to ensure proof of insurance on the part of any construction subcontractor. 

One stated goal of this decision is to give "a general contractor strong incentive to retain subcontractors who have workers' compensation insurance because it otherwise has to pay the workers' compensation benefits and is liable for any common law damages."

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FROM THE NEWSROOM



(left to right: Maria Hickey Jacobson, John T. Farrey and James T. Huggard)



▲ Attorney Margaret R. Suuberg of our Worcester office, was recently published in Risk & Insurance®. Read the article on our website.

◀ Attorney James P. McLarnon, Jr. photographed Attorneys Hickey Jacobson, Farrey and Huggard at the Burns and Farrey-sponsored hole during a golf tournament benefiting the Western Massachusetts Mental Health Association.



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