United States Fid. & Guar. Co. v American Re-Insurance Co.
2010 NY Slip Op 32441(U)
August 17, 2010
Sup Ct, NY County
Docket Number: 604517/02
Judge: Richard B. Lowe
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SCANNED ON 8/20/2010

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HON. RICHARD B. LOWE, III — Justice

PART 56

United States Fidelity v Guaranty

- v -

American Reinsurance

INDEX NO. 604517/03

MOTION DATE 3/31/10

MOTION SEQ. NO. 024

MOTION CAL. NO. ______

The following papers, numbered 1 to ______ were read on this motion to/for ______

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

FILED
AUG 20 2010
NEW YORK
COUNTY CLERK'S OFFICE

MOTION IS DECIDED IN ACCORDANCE
WITH ACCOMPANYING MEMORANDUM DECISION

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE
FOR THE FOLLOWING REASON(S):

Dated: 8/17/10

HON. RICHARD B. LOWE, III
J.S.C.

Check one: X FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: I.A.S. PART 56

---X

UNITED STATES FIDELITY & GUARANTY COMPANY, et. al.,

Plaintiffs,

Index No. 604517/02

-against-

DECISION AND ORDER

AMERICAN RE-INSURANCE COMPANY, et al.,

Defendants.

---X

FILED
AUG 20 2010
NEW YORK
COUNTY CLERK'S OFFICE

RICHARD B. LOWE, III, J:

Motion sequence numbers and 019 (also designated as 027), 024, 025 and 026 are consolidated for disposition.

In 2002, plaintiffs United States Fidelity & Guaranty Company (USF&G), The St. Paul Fire & Marine Insurance Company, and The St. Paul Companies, Inc. (collectively with USF&G, the USF&G Parties) settled an insurance coverage action entitled *Western MacArthur Co., et al., v United States Fidelity & Guaranty Co., et al.*, No. 721595-7 (Cal Super Ct Alameda County) (the Underlying Coverage Action") wherein plaintiffs agreed to pay $987.4 million in satisfaction of all asbestos injury-related claims made against Western Asbestos, a USF&G policyholder. Having paid the settlement, the USF&G Parties now seek to recover a portion of their losses under reinsurance treaties issued by the defendants.

In motion sequence number 019, defendant American Re-Insurance Company (American Re) moves, pursuant to CPLR 3212, for partial summary judgment declaring that: 1) American Re has no obligation to reimburse USF&G for payments to asbestos claimants who received $100,000 or less of USF&G's money; 2) American Re has no obligation to reimburse USF&G

for payments in excess of $200,000 to any claimant; 3) USF&G has the burden to prove that each claimant for whom it seeks reimbursement was exposed to asbestos before the last insurance policy USF&G issued to Western Asbestos; 4) USF&G has the burden to prove that each claimant for whom it seeks reimbursement was exposed to the asbestos of its insured, Western Asbestos Company (Western Asbestos); and 5) The $87.3 million that USF&G paid for legal fees of adverse parties and administrative expenses are not covered by reinsurance. The USF&G Parties originally cross-moved, pursuant to CPLR 3212 (e), for partial summary judgment, but have since amended their application, and now move for summary judgment in motion sequence 024.

In motion sequence 024, the USF&G Parties move, pursuant to CPLR 3212, for summary judgment as follows: (1) On the causes of action for breach of contract and beach of implied covenant of good faith and fair dealing against defendant American Re-Insurance Company n/k/a Munich Reinsurance America, Inc. (American Re), awarding USF&G compensatory damages in the amount of $202,507,261.50 together with interest thereon, and (2) On the causes of action for breach of contract and breach of implied covenant of good faith and fair dealing against defendant Excess Casualty Reinsurance Association (ECRA) and the remaining constituent pool members, defendants ACE Property and Casualty Company (ACE), Century Indemnity Company (Century), OneBeacon American Insurance Company (OneBeacon), American Home Assurance Company (American Home) and American Re, awarding USF&G compensatory damages in the aggregate amount of $59,786,218.81, together with interest thereon.

In motion sequence 025 defendant American Home moves, pursuant to CPLR 3212, for summary judgment and/or partial summary judgment, dismissing the complaint.

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In motion sequence number 026, ACE, Century, OneBeacon, ECRA and Excess & Treaty Management Corporation (ETMC) (collectively, the ECRA defendants) move, pursuant to CPLR 3212 for summary judgment, dismissing the complaint.

The Underlying Action

Between 1948 and 1960, plaintiffs USF&G issued a number of liability insurance policies to Western Asbestos Company (Western Asbestos), a company that operated in California, where it sold and distributed insulation products containing asbestos manufactured by Johns-Manville Company. Subject to the terms, conditions, exclusions, and limitations of the Western Asbestos policy, USF&G insured Western Asbestos against liability for bodily injury and/or property damage caused by an "accident." Specifically, the Western Asbestos policy provided coverage for losses arising out of hazards relating to the products and business operations of Western Asbestos.

In the mid-1960s, Western Asbestos ran into financial trouble. In 1967, the MacArthur Company, which sold and installed asbestos products in the mid-west, decided to expand its business into California and formed the Western MacArthur Company (Western MacArthur). Western MacArthur purchased most of the operating assets of Western Asbestos, and took over its business. Thereafter, Western Asbestos filed a certificate of dissolution. Individuals injured by asbestos began suing Western MacArthur in the late 1970s, both in its own right, and as successor to Western Asbestos.

Subject to the terms, conditions, exclusions, and limitations of the Western Asbestos policy, USF&G insured Western Asbestos against liability for bodily injury and/or property damage caused by an "accident." Specifically, the Western Asbestos policy provided coverage for losses arising out of hazards relating to the products and business operations of Western Asbestos.

In 1993, Western MacArthur initiated the Underlying Coverage Action against USF&G and two other Western Asbestos insurers in the Superior Court for Alameda County, California, seeking damages and a declaration that USF&G had a duty to defend and indemnify Western MacArthur against the asbestos-related personal injury claims.

In response, USF&G argued that the entity prosecuting the Underlying Coverage Action, Western MacArthur, lacked standing to sue USF&G for breach of insurance policies that USF&G issued to Western Asbestos. Western MacArthur argued that insurance coverage purchased by Western Asbestos transferred to Western MacArthur by operation of law, but in 1997, the California Court of Appeals ruled that Western MacArthur was not entitled to Western Asbestos's insurance coverage (*General Accident Ins. Co. v Superior Court*, 55 Cal App 4th 1444, 1445 [1st Dist 1997]). As a result of this decision, USF&G took the position that it had no obligations to Western MacArthur.

Neither Western MacArthur nor USF&G could locate the insurance policies in issue. USF&G therefore argued that it had no liability because it never provided products liability coverage to Western Asbestos, and that, even if it did, its standard policies at the time did not provide products coverage. Finally, USF&G argued that even if it had provided insurance, the policies would have limited the aggregate amount of such coverage.

The trial of the Underlying Coverage Action began on March 26, 2002. In order to defeat USF&G's objections to standing, Western MacArthur found a former officer of Western Asbestos, and persuaded him to sign an assignment of insurance rights to Western MacArthur.

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Western MacArthur also convinced a California court to "revive" Western Asbestos after the fact to ratify the assignment. In May 2000, Western Asbestos intervened in the Underlying Coverage Action as a plaintiff. Thereafter, the trial court ruled that USF&G lacked standing to challenge the purported assignment of insurance rights to western MacArthur. These developments represented a significant defeat for USF&G.

With respect to the issue of the lost policies, the plaintiffs in the Underlying Coverage Action presented secondary evidence that USF&G's lost policies provided products coverage without aggregate limits. At this point, USF&G determined that its downside exposure potential was enormous, and it engaged in global settlement discussions.

The Settlement Agreement

On June 3, 2002, after almost 10 years of litigation, the parties reached a settlement. Pursuant to a Settlement Agreement, entered into between MacArthur Company, Western MacArthur Company and Western Asbestos Company (the Western Plaintiffs), the "Asbestos Plaintiffs" (defined as individuals holding asbestos-related claims represented by Asbestos Plaintiffs' Counsel) and the USF&G Parties, USF&G agreed to pay $975 million plus interest, which would be disbursed as follows: 1) $160 million plus interest into a judgment escrow for those claimants who already held judgments against the Western Plaintiffs; 2) $940 million into a bankruptcy trust for current and future claims (the Trust); 3) All costs and fees from and including May 17, 2002, as incurred, in connection with the handling and defense of asbestos-personal injury claims brought against the Western Plaintiffs; and 4) $12.3 million to the Asbestos Plaintiffs' Counsel (Yessman Aff., Ex. C, Settlement Agreement).

As contemplated by the Settlement Agreement, Western Asbestos, Western MacArthur

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and MacArthur Company filed for bankruptcy protection and sought relief under section 524 (g) U S Bankruptcy Code, which allows companies with asbestos-related liability to obtain an injunction barring all past, present and future claims in exchange for the creation of a trust fund for the compensation of existing and future asbestos claimants (*see*, 11 U S C § 524 [g]).

According to USF&G, settlement negotiations centered on ascertaining the amount of Western MacArthur's past, present and future asbestos liability. In negotiating the settlement, the parties treated each claimant as a separate accident under USF&G's policies. The parties also assumed that an asbestos claimant could recover from USF&G only if he or she was exposed to or suffered an asbestos injury from a Western Asbestos product or from the operations of Western Asbestos during the stipulated period of USF&G's coverage, which was from 1948 through 1960.

USF&G contends that it was able to use California law to limit its obligations under the Settlement Agreement. According to USF&G, under certain California appellate court cases, insurers are required to pay "all sums," up to the policy limit of the insured's liability, not just liability allocable to damage during the policy period. USF&G contends that it mitigated the effect of these cases by successfully arguing that the limits of successive policies triggered by a single claim or injury could not be aggregated or stacked to increase the available coverage. Rather, USF&G argued, and the parties settled, on the basis that the policyholder could seek recovery under only a single policy. The Settlement Agreement was structured so that all losses were deemed to have occurred in 1959. Prevailing on this point in the negotiations meant that USF&G's liability to any particular asbestos claimant was necessarily limited to the coverage available in a single year.

In negotiating the Settlement Agreement the parties' experts used prevailing jury verdicts and settlement values to assign each type of asbestos-related injury a dollar value:

Mesothelioma:	$500,000
Lung Cancer:	$200,000
Other Cancer	$20,000
Asbestosis:	$50,000
Pleural:	$20,000

Thereafter, with respect to present and future claims for various plaintiffs having the most serious injuries, including mesothelioma and lung cancer, the parties capped that liability at $200,000 per claimant as per the applicable insurance policy, and then calculated USF&G's estimated liability, by multiplying the estimated number of present and future plaintiffs by $200,000.

For asbestosis, which the experts projected to result in a recovery of $50,000 for each present and future claimant, USF&G was assigned responsibility for the full amount of such claims. Its potential liability was therefore the estimated number of present and future plaintiffs multiplied by $50,000.

In preparing the reinsurance bill, with respect to present and future claimants, USF&G alleges that it retained half for itself, to satisfy the $100,000 treaty retention, and ceded only the other half to its reinsurers. Further, USF&G alleges that in submitting its reinsurance bill it did not include asbestos claimants because these projected recoveries fell within the $100,000 retention.

As to prior judgments, USF&G's liability was capped at $200,000. In billing its reinsurers for past judgments, USF&G alleges that did not bill prior judgments under $100,000 to its reinsurers, and billed only those amounts between $100,000 and $200,000 to American Re and ECRA (Grais Aff., Ex. C [Reins. Bill], at 4 - 6).

USF&G alleges that the Asbestos Plaintiffs' counsel believed that Western MacArthur faced more than $5 billion in asbestos liability and that USF&G was responsible for over $2 billion of that liability. Thus, USF&G contends that its settlement of the Underlying Coverage Action for $975 million, plus interest, was significantly less than the amounts initially demanded by the plaintiffs.

Finally, as to the issue of attorneys' fees, Western MacArthur and the Asbestos Plaintiffs requested that a portion of the settlement be "earmarked" for certain attorneys' fees and costs. According to USF&G, the issue of what portion of the settlement should be paid to lawyers was discussed only after the settlement amount had been arrived at as a result of negotiations over the amount of USF&G's coverage obligations.

The Reinsurance Treaties

In May 1956, USF&G entered into a reinsurance treaty with American Re, identified as Treaty No. 3995-15 (the American Re Treaty), effective January 1, 1956 to January 1, 1962. Pursuant to the American Re Treaty, American Re agreed to pay USF&G 50% of the excess over $100,000 for any one loss, up to a limit of $3 million per loss, paid by USF&G in connection with direct insurance policies in force, issued, or renewed by USF&G, on or after January 1, 1956.

USF&G also entered into an additional contract for reinsurance with the ECRA. ECRA was an unincorporated association of insurance companies. At the time the treaty was entered into, ECRA consisted of 20 member companies, each of which was assigned a specific share of

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the profit and loss generated by ECRA's reinsurance contracts. ECRA issued a separate treaty to USF&G (the ECRA Treaty), under which ECRA insured the other 50% of losses over $100,000 paid in connection with USF&G's policies which were in effect in 1959.

Both of the reinsurance treaties contain a "follow the fortunes" or "follow the settlements" clause, which provides as follows:

> All claims in which this reinsurance is involved, when allowed by the Company [USF&G], shall be binding upon the Reinsurers, which shall be bound to pay or allow, as the case may be, their proportion of such loss . . . . the Company shall have the right to defend, settle, or compromise any such claims, suit or proceeding, and such action on the part of the Company shall be binding upon the Reinsurers

(Kane Aff., Ex. 1 [Complaint], Ex. A [Treaty, ¶ 6]).

Motion Sequence 019

As noted above, American Re seeks partial summary judgment declaring that USF&G's claim for reinsurance is limited to American Re's share of (i) amounts over $100,000 and up to $200,000 of USF&G's money paid to each claimant, (ii) who USF&G can prove was exposed to asbestos before July 1960, and (iii) who USF&G can prove was exposed to the asbestos products or operations of its insured.

American Re argues first, that under the terms of the treaty, USF&G must retain the first $100,000 of loss paid actually paid to each asbestos claimant, and that, therefore, American Re has no obligation to reimburse USF&G for payments to asbestos claimants who received $100,000 or less of USF&G's money. Second, American Re asserts that the underlying policies issued by USF&G only covered loss of up to $200,000 per person. American Re contends that, under the Settlement Agreement, some claimants nevertheless received more than $200,000 of

USF&G's money. Payments above that amount are beyond the scope of USF&G's policies and are, therefore, as a matter of law, not covered by the reinsurance of those policies.

In addition, American Re argues that the last policy that USF&G issued to Western Asbestos expired in July 1960. Under the Settlement Agreement, USF&G's money was put into the Trust, and therefore, some of USF&G's funds were paid to claimants who could not have been exposed to asbestos by 1960, such as those who were not yet born or were born too late to be of working age by then. Because payments to such claimants are beyond the scope of USF&G's policies under any theory of coverage of asbestos liabilities, as a matter of law, those payments are not covered by American Re's reinsurance of USF&G's policies. American Re further asserts that, as the plaintiff in this action for reinsurance coverage, USF&G has the burden to prove that each claimant for whom its seeks reimbursement was exposed to asbestos before the expiration of its last policy in July 1960.

American Re also argues that USF&G money has paid claims for those who were exposed to the asbestos products of three different companies, only one of which was insured by USF&G. American Re contends that, as the plaintiff in this action, USF&G has the burden to prove that each claimant for whom it seeks reimbursement was exposed to the asbestos of its insured, not the other two companies.

Finally, American Re notes that USF&G paid $87.3 million in coverage expenses for purposes other than to compensate victims of exposure to asbestos. This included $40 million to the attorneys for the three asbestos companies, $12.3 million to the attorneys for the asbestos claimants, and $35 million toward the expected administrative expenses of the Trust with respect to the Underlying Coverage Action. American Re contends that these fees are not recoverable

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under the reinsurance treaties.

A "follow the settlements" clause, included in the reinsurance treaty herein, requires the reinsurer (American Re), to indemnify the reinsured (USF&G), for payments made that are reasonably within the terms of the original policy (*North River Ins. Co. v Ace Am. Reins. Co.*, 361 F3d 134 [2d Cir 2003]).

> [T]he doctrine imposes a contractual obligation upon the reinsurer to indemnify the ceding company for payments it makes pursuant to a loss settlement under its own policy, provided that such settlement is not fraudulent, collusive or otherwise made in bad faith, and provided further that the settlement is not an ex gratia payment, i.e., one made by a party that recognizes no legal obligation to pay, but makes payment to avoid greater expense, as in the case of a settlement by an insurance company to avoid the cost of a suit

(*Granite State Ins. Co. v Ace Am. Reins. Co.*, 46 AD3d 436, 439 [1st Dept 2007], citing *Aetna Cas. And Sur. Co. v Home Ins. Co.*, 882 F Supp 1328 [SD NY 1995]).

"The purpose of the 'follow the fortunes' or 'follow the settlements' doctrine in reinsurance law is to prevent the reinsurer from 'second-guessing' the settlement decisions of the ceding company" (*Granite State Ins. Co. v ACE Am. Reins. Co.*, 46 AD3d at 439, quoting *Aetna Cas. and Sur. Co. v Home Ins. Co.*, 882 F Supp at 1346). It is intended to avoid re-litigating coverage issues under the insured's policies and to promote good faith settlement of the insured's claims (*Allstate Ins. Co. v American Home Assur. Co.*, 43 AD3d 113 [1st Dept 2007]).

Here, American Re does not allege that USF&G's settlement in the underlying action was made in bad faith or that it constituted an ex gratia payment. Rather, its argument is that this Court should examine the actual distribution made to particular claimants under the Trust distribution procedures, and determine whether the amount *actually received by each claimant* implicates American Re's reinsurance obligations.

As an initial matter, the treaty is a reinsurance contract between USF&G and American Re, and addresses USF&G's losses pursuant to its underlying policy, not the actual recovery by individual claimants as against USF&G's insured. Moreover, under the follow the settlements doctrine, the standard by which a settlement agreement of a ceding company is judged is whether "the cedent's good faith payment is at least arguably within the scope of the insurance coverage that was reinsured" (*Granite State Ins. Co. v ACE Am. Reins. Co.*, 46 AD3d at 439). Here, American Re does not challenge USF&G's allegations as to its computation of the settlement amount. Any further inquiry into the actual recovery of each claimant would constitute the kind of re-litigation that the follow the fortunes doctrine is designed to avoid.

American Re's argument that some of USF&G's settlement money will be used to compensate asbestos-related injuries occurring after 1960, and is therefore outside the scope of its reinsurance, apparently stems from the fact that the settlement agreement in the underlying action includes Western Asbestos, MacArthur and Western MacArthur. However, the MacArthur parties were included in the underlying coverage dispute because Western MacArthur purchased the assets and took over the business of Western Asbestos. USF&G has alleged that it calculated its potential liability assuming only claimants who were exposed to or suffered an asbestos injury from a Western Asbestos product or from the operations of the Western Asbestos during the period of USF&G's coverage. American Re has failed to present any evidence whatsoever that USF&G calculated other non-covered potential victims in its settlement figures.

As to American Re's objection to paying any portion of the settlement involving administrative expenses and/or lawyers' fees, again, American Re is seeking to look behind the settlement amount, which it has not challenged, and thereafter deduct those amounts which it deems outside of its re-insurance obligations. According to USF&G, the settlement amount, as well as American Re's obligations thereon, were calculated with reference to USF&G's underlying policy limitations and the reinsurance treaties.

The ECRA Motions

In motion sequence number 026, the ECRA defendants move, pursuant to CPLR 3212, for summary judgment dismissing the complaint.

First, the ECRA defendants assert that USF&G's reinsurance bill improperly employed an occurrence trigger for the reinsurance allocation. An "occurrence" trigger assigns liability to all policies in effect from the time of initial exposure to asbestos until death, the "accident" trigger narrowly assigns liability, at most, only to those policies in effect when the victim was initially exposed to asbestos. According to the ECRA defendants, USF&G prevailed and avoided the application of the materially broader "occurrence" trigger in the case with its insured, but switched rules and used the occurrence trigger for its allocation to the Reinsurers to attempt to broaden the number of claims that are reinsured.

USF&G acknowledges that, during the underlying action it sought to limit its liability by asserting that the continuous trigger doctrine was inapplicable because the underlying policies were written on a "caused by accident" as opposed to "occurrence" basis. USF&G asserts that it ultimately compromised on this issue. Thus, the Settlement Agreement was based upon an occurrence basis of liability. Nonetheless, the parties also negotiated that only one of the policies issued by USF&G–the policy issued in 1959–could be called upon to respond to the underlying asbestos claims. According to USF&G, there were several reasons for doing this.

First, under the California "all sums" rule, although a policy is triggered only if bodily injury or property damage takes place during the policy period, once a policy is triggered, the policy obligates the insurer to pay "all sums" up to the policy limit, which the insured shall become liable to pay as damages, and not just for damages that occur during the policy period (*Aerojet-General Corp. v Transport Indem. Co.*, 17 Cal 4th 38, 57 n10 [1997], citing *Armstrong World Indus., Inc. v Aetna Cas. & Sur. Co.*, 45 Cal App 4th 1 [1996]). USF&G states that it sought to minimize the effect of this rule by providing that any recovery would be limited to the per person limit under a single USF&G policy (i.e., no stacking of policies) with the highest available limit being the 1959 policy of $200,000. USF&G asserts that, when it prepared the reinsurance billing, it ceded claims to the reinsurers in the same manner in which its payments were allocated under the Settlement Agreement– to the last policy period.

While USF&G could have settled the underlying coverage action in a manner that would have had a lesser impact on its reinsurers–such as allocating future claimants' predicted recoveries over several policy periods, it was not required to choose the method that would have had the least impact on its reinsurers:

> Whenever settlements are made in cases involving multiple policies and multiple insurers and reinsurers, numerous good faith methods of allocation will be available and under consideration, but only one will ultimately be chosen in terms of the payments actually made. To allow reinsurers to second-guess that allocation would be to make settlement impossible and reinsurance itself problematic

(*North River Ins. Co. v ACE Am. Reins. Co.*, 2002 WL 506682, *3 [SD NY 2002], *affd in relevant part, revd in part*, 361 F2d 134 [2d Cir 2004]). Further, "a cedent choosing among

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several reasonable allocation possibilities is surely not required to choose the allocation that minimizes its reinsurance recovery to avoid a finding of bad faith" (*Travelers Cas. & Sur. Co. v Gerling Global Reins. Corp. of Am.*, 419 F3d 181, 193 [2d Cir 2005]). Nor, as suggested by ECRA, was USF&G's reinsurance allocation at odds with its allocation of the loss with its insured (*c.f. Allstate Ins. Co. v Am. Home Assur. Co.*, 43 AD3d 113, *supra.*).

ECRA also asserts that, under California law, when an occurrence trigger is employed, thereby implicating multiple responsible policies, under the doctrine of equitable contribution, all of the policies issued by USF&G are liable for a proportion of the loss. ECRA argues that, employing this doctrine, it has no liability to USF&G because each $200,000 claim must be pro rated over several policies.

The California courts have applied the doctrine of equitable contribution only to multiple *insurers* of the same loss:

> the right to contribution arises when several insurers are obligated to indemnify or defend the same loss or claim, and one insurer has paid more than its share of the loss . . . . Equitable contribution permits reimbursement to the insurer that paid on the loss for the excess it paid over its proportionate share of the obligation . . . .

(*Fireman's Fund Ins. Co. v Maryland Cas. Co.*, 65 Cal App 4th 1279, 1293 [1st Dist 1998]). The California Supreme Court has stated that "[e]quitable contribution applies *only* between insurers . . . and *only* in the absence of contract" (*Aerojet-General, supra.*, 17 Cal 4th at 72 [citations omitted, emphasis in original]).`

ECRA also argues that the California Supreme Court has indicated that, when successive policies are triggered, it is appropriate to look to the parties' "other insurance" clause to apportion the loss between policies (*Aerojet General,* 17 Cal 4th at 57 n10). Thus, it reasons, if

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other insurers would be held liable under successive policies, so too should the loss be apportioned over USF&G's successive policies. However, the California Supreme Court has held that "'[o]ther insurance' clauses become relevant only where several insurers insure the same risk at the same level of coverage" (*Dart Indus., Inc. v Commercial Union Ins. Co.*, 28 Cal 4th 1059, 1079 n 6 [2002]). Here again, although USF&G could have negotiated a settlement using all policies, the follow the settlements rule does not require it.

ECRA next argues that, in 1981, the parties retroactively amended all reinsurance treaties with USF&G to provide a retention, per loss, of $3 million, as opposed to $100,000. The retention is the amount that USF&G must pay before the reinsurers' liability is triggered. If this were the case, it would effectively end the current litigation because the $3 million retention would cover the settlement amounts on every claim. However, the parties only drafted and signed policy endorsements increasing the retention of post-1962 reinsurance treaties. The Treaty at issue herein was for the year 1959. ECRA contends that contemporaneous documents indicate that the parties intended to amend all treaties, including those in effect prior to 1962. ECRA submits evidence from several sources, including a memo and the deposition testimony of Thomas Rentko, ECRA's negotiator in 1981, the deposition testimony of James Steen, a USF&G broker in 1981, and a 1987 memo from Brady Wallace, a USF&G employee, who was not present at negotiations in 1981.

First, ECRA submits a memo authored by Thomas Rentko, dated June 22, 1981, which states, in part, that the parties had agreed that "[a]ll new losses reported to reinsurers on and after July 1, 1981 will be subject to a $3,000,000 retention regardless of the date of loss (Carlinsky Aff., Ex. 57). In addition, at his deposition, Rentko stated that "[m]y intent on that was to go back to unreported losses. I don't want to pick out any years. If the claims came out of the woodwork in '62 or '59, I could care less. I didn't want to have to get into the new calendar year loss exposures" (Carlinsky Aff., Ex 58, at 271)

However, on June 19, 1992, Randall White, a vice president of Guy Carpenter, the brokerage firm representing USF&G, wrote in a memo to Rentko: "*All new claims against USF&G's 'old first layer' casualty cover (in force from 1/1/62 to 6/30/80) will be subject to a $3,000,000 retention.* The term 'new claims' means claims first reported to reinsurers on or after 7/1/81." On his copy of the letter, Rentko wrote: "This is correct– See notes in file." Rentko signed and dated that letter (Kane Aff. Ex. 38) (emphasis added).

In fact, several additional correspondence from Guy Carpenter, indicate that the brokerage firm believed that the retroactive increases in USF&G's retention was limited to post-1962 policies (*see e.g.* Letter from Guy Carpenter [Gerard T. Tanella], 11/15/91, Kane Aff., Ex. 75; Letter from Guy Carpenter [Gerard T. Tanella], 4/8/88, Kane Aff., Ex. 39).

Next, the ECRA defendants submit the deposition testimony of James Steen, who states in a 2008 affidavit that, in 1981 "USF&G agreed to retain more of the losses prior to July 1980 through a retroactive increase in their retention to $3 million on any newly reported claims (Carlinsky Aff. Ex. 59). However, Steen also states that: "[w]ith respect to the retroactive increase in retention, *I do not remember any discussion about limiting how far back that would go.* I understood that it was intended to go all the way back to the beginning of each reinsurer's involvement with the Program" (*id.*) (emphasis added).

However, in a letter dated June 19, 1981, USF&G wrote to Steen, in part, as follows: "[c]onfirming our conversation today, we are authorizing you to negotiate a 2¢% to 5¢% payback rate specifically applicable to the "old" Casualty Excess First Layer with the understanding that new reported losses to the treaty after July 1 will carry a $3,000,000 retention" (Carlinsky Aff., Ex 56).

USF&G states that the "old first layer" referred to 1962 inasmuch as that was the first year that USF&G's first and second layers of reinsurance coverage were in separate treaties (Joseph Conwell Aff., ¶3). This reference to the "old excess" is supported by Randall White's letter to Rentko, noted above.

In addition, a letter from Steen to Joseph Conwell, Assistant Secretary of USF&G, dated June 3, 198,1 indicates that the parties were changing the "old" first excess layers of insurance:

> We have recently discussed with American Reinsurance Company and Excess & Casualty Reinsurance Association (ECRA) *their position in renewing this First Casualty Excess layer* of your reinsurance program as of July 1, 1981 . . . .
>
> Neither American Re nor ECRA have provided us with definitive quotations for the renewal of this layer. As you know, the U.S.F.&G. retention was increased from $1,000,000 to $3,000,000 effective July 1, 1980. The three reinsurers on the "old" First Excess were moved to the "new" first Excess - which is now $4,000,000 excess of $3,000,000 . . . .
>
> The developing experience under the "old" first excess is of concern to the reinsurers. They have asked that we discuss with you the impact of this development in respect of the continuing relationship that each has with the U.S.F.&G. as reinsurers of the "new" First Excess.
>
> All of this will be the subject of our discussion with you, Karl Doerre and George Bookhout on Thursday morning, June 4, 1981

(Kane Aff. Ex. 72) (emphasis added).

Finally, the ECRA defendants present the memo of Brady Wallace, a senior officer of USF&G, who, admittedly, was not involved in the 1981 negotiations, but who, in 1987, opined the following: "It seems to me that the intent was for the retroactive endorsements to apply to contracts prior to 1962 although the earlier contracts were not endorsed" (Carlinsky Aff., Ex. 54, at 2).

However, in July 1992, when Guy Carpenter circulated revised versions of the post-1962 endorsements, Wallace signed them on behalf of USF&G.

In opposition to ECRA's motion, USF&G submits the affidavit of Joseph Conwell, who was employed by USF&G from 1955 through 1992 and was USF&G's Superintendent of Reinsurance in the early 1980s. Conwell states that he had personal knowledge of the terms and conditions of USF&G's reinsurance coverage and that the parties never intended to change the pre-1962 treaties. Conwell states, in part, that:

> The discussions concerning the $3 million retention increase concerned only reinsurance treaties issued between 1962 and 1980 (i.e., the "old First Excess"). Neither I nor anyone else at USF&G ever intended to increase the retentions of any treaties with effective dates before 1962, and USF&G never agreed to increase such retentions. The retentions in pre-1962 treaties were $50,000 from 1945 to 1951 and $100,000 from 1951 to 1962.
>
> There are a number of reasons why our negotiations concerned only the post-1962 reinsurance treaties. First and foremost, in the 1980's the reinsurers were not suffering losses in the pre-1962 years, and thus there was no reason to seek modification of those treaties . . .

(Conwell Aff.).

Further, USF&G also submits several 1981 memoranda authored by American Re, which expressly acknowledge that American Re, which held the other 50% risk on the reinsurance, did not seek to extend the retention increase to pre-1962 treaties. A July 13, 1981 memo on American Re stationery states, in part, that "[s]ince when discussing the payback concept with [Guy] Carpenter we used our experience figures back to 1962, and because what we know of the years prior to 1962 suggest we made money I suggest we endorse our $3,000,000 retroactive retention back to 1/1/62" (Kane Aff., Ex. 45). An August 5, 1981 American Re memo, states "[a]s a follow-up to my recent previous memorandum, we have decided not to go back beyond accident year 1962 for purpose of moving to the $3,000,000 retention as respects losses first reported on or after 7/1/81 (Kane Aff., Ex. 46).

"It is well established that when interpreting an insurance contract, as with any written contract, the court must afford the unambiguous provisions of the policy their plain and ordinary meaning *(Greater N. Y. Mut. Ins. Co. v United States Underwriters Ins. Co.*, 36 AD3d 441, 442 [1st Dept 2007], citing *United States Fid. & Guar. Co. v Annunziata*, 67 NY2d 229 [1986]; *see also Riverside S. Planning Corp. v CRP/Extell Riverside, L.P.*, 60 AD3d 61, 66 [1st Dept 2008]).

The ECRA defendants ask this Court to reform the 1959 treaty to reflect what they assert was the parties' true intention–to change the retention of the pre-1962 treaties from $100,000 to $3 million. As the proponent of reformation, the ECRA defendants have the burden to prove first, that the parties' failure to endorse the pre-1962 treaties was the result of either mutual mistake or unilateral fraud, and second, exactly what was really agreed upon between the parties (*Greater New York Mut. Ins. Co. v U.S. Underwriters Ins. Co.,* 36 AD3d at 443; *William P. Pahl Equip. Corp. v Kassis*, 182 AD2d 22 [1st Dept], *lv. dismissed in part and denied in part*, 80 NY2d 1005 [1992]). Here, the ECRA defendants have failed to present sufficient evidence to raise an issue of fact as to either mutual mistake or fraud on the part of USF&G. Further, it is

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clear that, USF&G, Guy Carpenter and American Re intended the new retentions to affect only post 1962 treaties.

Next, the ECRA defendants assert that some portion of USF&G's nearly $1 billion settlement is compensation that should be attributed to Western's bad-faith claim, which is not covered by reinsurance. According to ECRA, the United States Bankruptcy Court found that a substantial portion of USF&G's settlement "must be attributed" to bad-faith claims against USF&G. The ECRA defendants assert that USF&G is collaterally estopped by the Bankruptcy Court decision from asserting that no part of its settlement is attributable to Western Asbestos's bad faith claim against it.

The doctrine of collateral estoppel precludes a party from re-litigating an issue that was raised in a prior action and decided against that party (*Ryan v New York Tel. Co.*, 62 NY2d 494 [1984]).

In a decision approving the creation of the Trust, United States Bankruptcy Judge Leslie Tchaikovsky noted that the Settlement Agreement required the issuance of injunctions enjoining the prosecution of asbestos claims against the debtors and the settling insurers and channeling future asbestos claims to the Trust. The Court stated that to confirm the plan and issue the required injunctions the Court must find that both the plan and its proponents satisfied the requirements of both 11 USC §§ 1129 and 524 (g).

Section 1129 (a) (3) required the Court to find that the plan had been "proposed in good faith and not by any means forbidden by law." The Court stated that the "Objecting Insurers" (i.e., those who had not reached a settlement with Western Asbestos) contended that the plan was filed in bad faith and that the debtors had acted in bad faith, which was shown by their unwillingness to contribute more to the Trust. The Objecting Insurers contended that the proceeds from the USF&G and Hartford Settlement Agreements, which were the primary contribution to the Trust, either belonged to the asbestos claimants already or were without value. In response, Judge Tchaikovsky wrote as follows:

> This argument ignores the value of the Debtors' bad faith claims against Settling Insurers. As discussed below, the evidence presented at the confirmation hearing convinced the Court that the Debtors had colorable claims for bad faith against each of these two insurers. While the Court cannot allocate to these bad faith claims a specific percentage of the settlement amounts, even if the bad faith claims represents only ten percent of the settlement amount, this gives them a value of approximately $200 million *19.
>
> n19. *The Court is not deciding here the merit or specific value of any potential bad faith claim* that was or could have been raised in a state court insurance coverage action. Rather, the Court simply determines that the Debtors' contribution to the Trust was substantial

(Pedlar Aff., Ex. D, at 25) (emphasis added).

Thus, although the Judge Tchaikovsky was required to find that Western Asbestos had acted in good faith and had contributed to the Trust, she specifically noted that she was not determining the merit or specific value of any potential bad faith claim in the bankruptcy proceeding. USF&G is not bound by the Bankruptcy Court finding on this issue because none was made. Nor have the ECRA defendants presented any further evidence that a portion of the settlement amount was attributable to Western Asbestos bad faith claim. They have, therefore, failed to raise an issue of fact as to this issue.

Finally, the ECRA defendants allege that there are issues of fact as to whether USF&G's reinsurance allocation was based upon fraudulently inflated claim values and fictitious future

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claim counts.

The ECRA defendants claim that, "in order to support its reinsurance billing, USF&G provided the Reinsurers with a completely fictitious list of default claimants. The list bore no relationship to the amount received by holders of default judgments or to the releases that those claimants had delivered to USF&G" (ECRA Memorandum of Law, at 40).

The ECRA defendants cite Henry Ailsworth as a specific example. Henry Ailsworth obtained a default judgment of $1.260 million against Western Asbestos and received $71,000 in partial satisfaction of his judgment out of the USF&G settlement funds, even though he was first exposed to asbestos in 1974, well after the 1959 policy-year for which the ECRA defendants provided reinsurance coverage (Carlinsky Aff., Exs. 78-79). The ECRA defendants assert that, by July 2000, before it billed the reinsurers, USF&G knew that Ailsworth, and many like him, had been paid a portion of the $160 million earmarked for the holders of default judgments. The ECRA defendants assert that, nonetheless, USF&G billed its reinsurers as if it had paid Ailsworth $200,000.

The ECRA defendants make essentially the same argument that American Re made– that once the settlement funds were put into the bankruptcy trust, claimants other than those who were liable under the USF&G policy received a portion of the funds, and conversely, some claimants, for whom USF&G had contributed $200,000, did not receive the total settlement attributable to them.

Here, again, while the ECRA defendants may challenge USF&G's good faith in settling the underlying action, and whether the settlement payments made by USF&G were ex gratia, or outside the scope of the underlying policy, the follow the fortunes doctrine prevents them from

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challenging the actual disbursement of funds to various claimants.

Along these lines, the ECRA defendants erroneously assert that USF&G created a "fraudulent" list of default judgments and sent it to the reinsurers as support for its November 2002 bill (Carlinsky Aff., Ex. 3). The ECRA defendants assert that, instead of revealing the actual recipients of the $160 million paid with respect to default judgments, USF&G created a list showing only claimants first exposed before 1960.

The list of default judgments prepared by USF&G supports its settlement of the underlying action in that it demonstrates that the default judgments rendered against its policyholder, Western Asbestos, for exposures to asbestos occurring prior to 1960, were far in excess of $160 million. Thus, USG&G's payments made to its policyholder were not ex gratia. The ECRA defendants argument is essentially that, because of the methods of distribution used by the Trust, some claimants who were not exposed prior to 1960 may have been paid with monies coming from USF&G. As already noted, the follow the fortunes doctrine prevents an inquiry into the ultimate distribution determinations of the Trust.

The ECRA defendants next allege that to "hide" the payments made to those not triggering a USF&G policy, USF&G inflated the payments made to claimants that might be reimbursable under the Treaty. The ECRA defendants point to another claimant, George Miller, who received only $15,679 in actual dollars and released USF&G for liability in that amount. Nonetheless, according to the ECRA defendants, USF&G improperly billed the Reinsurers $100,000 as if Mr. Miller had received $200,000 and released USF&G for that larger amount.

The list of default judgments, prepared by USF&G, indicates that George Miller was first exposed to asbestos in 1948, and obtained a default judgment against Western Asbestos in the

Amount of $277,800 (Carlinsky Aff., Ex. 3). Under the terms of the Settlement Agreement, Mr. Miller's claim was capped at $200,000, and USF&G paid that amount into the bankruptcy trust. USF&G then billed the reinsurers for $100,000, which was appropriate.

Finally, the ECRA defendants argue that all of the asbestos claims should be aggregated into one claim because a "loss" under the Treaty is defined as the aggregate loss arising out of each "accident." The Treaty further defines "accident" as "[an] accident or occurrence, or series of accidents or occurrences *arising out of any one event* (Kane Aff., Ex. 1, Ex. A). Aggregating all asbestos-related injuries into one event (i.e., the decision to use asbestos) would drastically limit the amount of reinsurance due from them in that the Treaty has a $3.1 million maximum limit per loss.

This manner of allocating the loss is, as already noted, contrary to the manner in which the Underlying Coverage Action was settled because each asbestos claimant therein was considered a separate accident or occurrence. Further, under both New York and California law, each asbestos-related injury is considered a separate "occurrence" or "accident" since each claimant is separately exposed to asbestos at different points in time (*see e.g. In re Prudential Lines Inc. v American S.S. Owners Mut. Protector and Indem Assn.*, 158 F 3d 65, 81 [2d Cir 1998]; *London Mkt. Insurers v Superior Ct. of Los Angeles County.*, 146 Cal App 4th 648, 661 [2d Dist 2007]).

In motion sequence 025 defendant American Home moves, pursuant to CPLR 3212, for summary judgment and/or partial summary judgment, dismissing the complaint on the basis set forth in ECRA's motion to dismiss. For the reasons stated above, the motion is denied.

USF&G's Motion for Summary Judgment

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In motion sequence 024, USF&G moves for summary judgment: (1) on its causes of action for breach of contract and breach of implied covenant of good faith and fair dealing against defendants American Re in the amount of $202,507,261.50, together with interest; and (2) on its causes of action for breach of contract and breach of implied covenant of good faith and fair dealing against defendant ECRA and the remaining constituent pool members; defendants Ace Property and Casualty Company, Century Indemnity Company, OneBeacon America Insurance Company, American Home Assurance Company and American Re, in the amount of $59,786,218.81, together with interest. The difference in the amounts claimed due from American Re and the ECRA defendants is the result of settlements by nine of the ECRA pool members.

In opposition to USF&G's motion for summary judgment, the ECRA defendants assert that there are issues of fact as to: (1) the retention amount, which ECRA asserts was amended to $3 million; (2) the amount of the settlement that is attributable to USF&G's bad faith in the underlying action; (3) USF&G's use of an "occurrence" trigger was improper; (4) USF&G's use of the "all sums" rule to allocate all liability to the 1959 policy was unreasonable; and (5) USF&G committed fraud and manipulated claims to increase its reinsurance bill. Each of these assertions has been discussed above and determined to be without merit.

American Re opposes USF&G's motion for summary judgment on the grounds that, to recover from the reinsurers, USF&G must establish both that its payments are covered by the Treaty and that it acted in good faith in its post-settlement allocation of loss to the reinsurers. American Re further contends that USF&G may not support its burden of proving good faith by relying on extrinsic evidence of what the parties to the Settlement Agreement purportedly agreed during negotiations, because the Settlement Agreement contains an integration clause. As an initial matter, the parol evidence rule cannot be invoked by a non-party to an agreement (*Robert v United States Shipping Bd. Emergency Fleet Corp.*, 240 N Y 474, 478 [1925]; *Matter of SIN, Inc. v Department of Fin. of City of N.Y.*, 126 AD2d 339, 344 [1st Dept 1987], affd. 71 NY2d 616 [1989]). In addition, American Re fought for, and was granted discovery of documents relating to settlement negotiations (*American Re-Ins. Co. v U.S. Fid. & Guar. Co.*, 19 AD3d 103 [1st Dept 2005]). American Re cannot now assert that the parties may not rely on information regarding settlement negotiations. Finally, "[a] reinsurer who seeks to avoid application of follow-the-fortunes by claiming bad faith . . . must make an 'extraordinary showing of a disingenuous or dishonest failure'" (*Travelers Cas. & Sur. Co. v Gerling Global Reins. Corp.*, 419 F3d 181, 191 [2d Cir 2005], quoting *North River Ins. Co. v CIGNA Reinsur. Co.*, 52 F3d 1194, 1216 [3d Cir 1995]). Neither American Re nor the ECRA defendants have made a sufficient showing of bad faith to require a trial.

Accordingly, based upon the foregoing it is

ORDERED that as to motion sequence 019 (also designated as 027), the motion by defendant American Re-Insurance Company for summary judgment is denied; and it is further

ORDERED that as to motion sequence 026, the motion by defendants Excess Casualty Reinsurance Association, ACE Property and Casualty Company, Century Indemnity Company, OneBeacon American Insurance Company, and Excess Treaty Management Corporation for summary judgment dismissing the complaint is denied; and it is further

ORDERED that as to motion sequence 025, the motion by defendant American Home Assurance Company for summary judgment dismissing the complaint is denied; and it is further

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ORDERED that as to motion sequence 024, the motion by plaintiff United States Fidelity and Guaranty Company for summary judgment is granted to the extent that plaintiff shall have judgment against defendant American Re-Insurance Company in the amount of $202,507,261.50 plus interest at the statutory rate, to be calculated as follows: $40,110,865.00 with interest from November 9, 2002; $162,026,951.50 with interest from May 29, 2003; and $369,445.00 with interest from July 4, 2004; together with costs and disbursements as taxed by the Clerk upon submission of an appropriate bill of costs; and it is further

ORDERED that plaintiff shall have judgment against defendants Excess Casualty Reinsurance Association, ACE Property and Casualty Company, Century Indemnity Company, OneBeacon American Insurance Company, and Excess Treaty Management Corporation in the amount of $59,786,218.81 plus interest at the statutory rate, to be calculated as follows: $11,841,930.67 with interest from November 2, 2002; $47,835,216.89 with interest from May 29, 2003 and $109,071.24 with interest from July 4, 2004, together with costs and disbursements as taxed by the Clerk upon submission of an appropriate bill of costs; and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

Dated: August 17, 2010

FILED
AUG 20 2010
NEW YORK
COUNTY CLERK'S OFFICE

ENTER:

J.S.C.