To Be Argued By:
MARY KAY VYSKOCIL
Time Requested: 30 Minutes

New York County Clerk's Index No. 604517/2002

Court of Appeals

STATE OF NEW YORK

UNITED STATES FIDELITY & GUARANTY COMPANY and
ST. PAUL FIRE & MARINE INSURANCE COMPANY,

Plaintiffs-Respondents,

—against—

AMERICAN RE-INSURANCE COMPANY; EXCESS CASUALTY REINSURANCE ASSOCIATION; ACE PROPERTY & CASUALTY COMPANY; CENTURY INDEMNITY COMPANY; and ONEBEACON AMERICA INSURANCE COMPANY,

Defendants-Appellants,

(*caption continued on inside cover*)

BRIEF FOR PLAINTIFFS-RESPONDENTS

MARY KAY VYSKOCIL
CHET A. KRONENBERG
RYAN A. KANE
JONATHAN M. WEISS
SIMPSON THACHER & BARTLETT LLP
425 Lexington Avenue
New York, New York 10017
Telephone: (212) 455-2000
Facsimile: (212) 455-2502
mkvyskocil@stblaw.com

Attorneys for Plaintiffs-Respondents United States Fidelity and Guaranty Company and St. Paul Fire and Marine Insurance Company

Date Completed: July 10, 2012

—and—

EXCESS AND TREATY MANAGEMENT CORPORATION; AMERICAN HOME ASSURANCE COMPANY; AETNA INSURANCE COMPANY OF CONNECTICUT; CONTINENTAL CASUALTY COMPANY; CONTINENTAL INSURANCE COMPANY; GENERAL FIRE & CASUALTY COMPANY; GREAT AMERICAN ASSURANCE COMPANY (f/k/a AGRICULTURAL INSURANCE COMPANY); GREAT AMERICAN INSURANCE COMPANY; HANOVER INSURANCE COMPANY; HARTFORD ACCIDENT & INDEMNITY COMPANY; INSURANCE COMPANY OF NORTH AMERICA; INSURANCE CORPORATION OF NEW YORK (f/k/a REINSURANCE CORPORATION OF NEW YORK); PROVIDENCE WASHINGTON INSURANCE COMPANY; SECURITY INSURANCE COMPANY OF HARTFORD; and TIG INSURANCE COMPANY OF COLORADO,

Defendants.

DISCLOSURE STATEMENT OF PLAINTIFFS-RESPONDENTS PURSUANT TO 22 NYCRR 500.1(f)

Pursuant to Rule § 500.1(f) of the Rules of Practice of the Court of Appeals, Plaintiffs-Respondents United States Fidelity and Guaranty Company and St. Paul Fire and Marine Insurance Company advise the Court that the following are corporate parents, subsidiaries or affiliates:

350 Market Street, LLC
AE Development Group, Inc.
American Equity Insurance Company
American Equity Specialty Insurance Company
Aprilgrange Limited
Arch Street North LLC
Athena Assurance Company
Auto Hartford Investments LLC
Bayhill Restaurant II Associates
Camperdown Corporation
Commercial Guaranty Insurance Company
Constitution Plaza, Inc.
Constitution State Services LLC
Coronation Insurance Company Limited
Countersignature Agency, Inc.
Discover Property & Casualty Insurance Company
Discover Specialty Insurance Company
F&G U.K. Underwriters Limited
Farmington Casualty Company
Fidelity and Guaranty Insurance Company
Fidelity and Guaranty Insurance Underwriters, Inc.
First Floridian Auto and Home Insurance Company
First Trenton Indemnity Company
Gulf Insurance Holdings U.K. Limited
Gulf Underwriters Insurance Company
Gulf Underwriters Insurance Company
Gulf Underwriting Holdings Limited
Gulf Underwriting Limited
Jupiter Holdings, Inc.
Northbrook Holdings, Inc.

Northfield Insurance Company
Northland Casualty Company
Northland Insurance Company
Northland Risk Management Services, Inc.
Peacockgrange Limited
Phoenix UK Investments LLC
Select Insurance Company
Select Insurance Company
SPAL Pension Trustees Limited
SPC Insurance Agency, Inc.
St. Paul Fire and Casualty Insurance Company
St. Paul Guardian Insurance Company
St. Paul London Properties, Inc.
St. Paul Medical Liability Insurance Company
St. Paul Mercury Insurance Company
St. Paul Protective Insurance Company
St. Paul Surplus Lines Insurance Company
Standard Fire Properties, LLC
Standard Fire UK Investments, LLC
TCI Global Services, Inc.
The Automobile Insurance Company of Hartford, Connecticut
The Charter Oak Fire Insurance Company
The Phoenix Insurance Company
The Premier Insurance Company of Massachusetts
The Standard Fire Insurance Company
The Travelers Companies, Inc.
The Travelers Home and Marine Insurance Company
The Travelers Indemnity Company
The Travelers Indemnity Company of America
The Travelers Indemnity Company of Connecticut
The Travelers Lloyds Insurance Company
The Travelers Marine Corporation
TIMCO ALPHA I, LLC
TIMCO ALPHA I, LLC
TPC Investments Inc.
TPC UK Investments LLC
TravCo Insurance Company
Travelers (Bermuda) Limited
Travelers ALPHA Holdings, Inc. (1)
Travelers Asia Pte. Ltd.
Travelers Casualty and Surety Company
Travelers Casualty and Surety Company of America
Travelers Casualty and Surety Company of Europe, Limited

Travelers Casualty Company of Connecticut
Travelers Casualty Insurance Company of America
Travelers Casualty UK Investments, LLC
Travelers Commercial Casualty Company
Travelers Commercial Insurance Company
Travelers Distribution Alliance, Inc
Travelers Excess and Surplus Lines Company
Travelers Guarantee Company of Canada
Travelers Indemnity U.K. Investments LLC
Travelers Insurance Company Limited
Travelers Insurance Group Holdings Inc.
Travelers Lloyds of Texas Insurance Company
Travelers London Limited
Travelers Management Limited
Travelers MGA, Inc.
Travelers Personal Insurance Company
Travelers Personal Security Insurance Company
Travelers Property Casualty Company of America
Travelers Property Casualty Corp.
Travelers Property Casualty Insurance Company
Travelers Syndicate Management Limited
Travelers Texas MGA, INC
Travelers Underwriting Agency Limited
USF&G Financial Services Corporation

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PRELIMINARY STATEMENT

For a decade, Appellants-Reinsurers have evaded their contractual obligations to reimburse Respondents United States Fidelity and Guaranty Company and St. Paul Fire and Marine Insurance Company (together, "USF&G") hundreds of millions of dollars, representing a fraction of the amount USF&G paid to settle thousands of underlying asbestos claims.[1] Reinsurers have tried to justify their brazen no pay strategy with an ever shifting series of defenses, rationalizations and attacks on USF&G and its settlement. But none of Reinsurers' *ex post* challenges to the underlying settlement can change the unassailable fact that under the plain terms of the parties' reinsurance contract (the "Treaty") and the centuries' old "follow the fortunes" doctrine it embodies, Reinsurers may not disclaim their contractual obligations to USF&G by second-guessing USF&G's claims handling and settlement decisions.

USF&G purchased reinsurance protection for its entire book of liability insurance business in order to transfer to Reinsurers an agreed upon

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[1] "Appellants-Reinsurers" or "Reinsurers" are: (i) American Re-Insurance Company ("AmRe"), which provides 50% of the Appellants' coverage under the reinsurance treaty at issue; and (ii) Excess Casualty Reinsurance Association ("ECRA"), a pool consisting of various insurance companies that collectively provide the other 50% of the treaty coverage, and certain of its pool members: ACE Property and Casualty Company, Century Indemnity Company, OneBeacon America Insurance Company and AmRe (the "ECRA Defendants").

portion of the risks USF&G insured.[2] Under the Treaty, Reinsurers agreed to pay all claims allowed or settled by USF&G in excess of $100,000 per "loss." The Treaty contains a broad "follow the fortunes" clause that vests in USF&G complete authority to "defend, settle, or compromise" any claim by a USF&G policyholder, with the result "binding upon the Reinsurers." A799 ¶ 6. Consistent with the Treaty's follow the fortunes clause, the Treaty mandates reimbursement within *48 hours* of USF&G's presentation of the reinsurance bill. *Id.* ¶ 7. Thus, the plain terms of the Treaty preclude Reinsurers from doing exactly what they have done for the past *ten* years—indefinitely delay reimbursement by continually flyspecking USF&G's settlement.

The "follow the fortunes" doctrine—the fundamental reinsurance principle memorialized in the Treaty—promotes the efficient resolution of insurance claims by requiring reinsurers to respect their cedents' settlement decisions and preventing reinsurers from later using against a cedent issues that were compromised with a policyholder as part of the settlement. While paying lip service to follow the fortunes, Appellants ask this Court to create exceptions to the doctrine that would distort it beyond recognition. Specifically, while

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[2] Insurance companies purchase and rely upon reinsurance to, among other things, "spread risks among a larger pool of insurers," *Nat'l Union Fire Ins. Co. v. Travelers Indem. Co.*, 210 F. Supp. 2d 479, 483 (S.D.N.Y. 2002), and "increase[] the insurer's capacity to insure other customers." *N. River Ins. Co. v. CIGNA Reins. Co.*, 52 F.3d 1194, 1199 (3d Cir. 1995) ("CIGNA"); *See also Sumitomo Marine & Fire Ins. Co. v. Cologne Reins. Co.*, 75 N.Y.2d 295, 301 (1990) ("Reinsurance is a means by which insurers reallocate their risk.").

acknowledging (as they must) that Reinsurers are bound by USF&G's decision to settle, Appellants contend that they have the right to challenge the various compromises and strategic judgments that formed the basis of the underlying settlement. Appellants attempt this end run around the follow the fortunes doctrine by disingenuously denominating those decisions "post-settlement allocation decisions" and then confecting an exception to the doctrine for such "allocation" decisions.

Contrary to Reinsurers' argument, there is no allocation exception to the follow the fortunes doctrine. As courts in New York and around the country have uniformly recognized, any attempt to carve out allocation decisions from follow the fortunes would render the doctrine a nullity. Because post-settlement allocation decisions are (as here) so often intertwined with pre-settlement coverage decisions, second-guessing allocation decisions is tantamount to questioning the underlying settlement itself. And thus, as courts consistently recognize, *de novo* review of *either* type of decision has an equal likelihood of undermining settlement and fostering litigation.

The decisions Reinsurers challenge on appeal—*e.g.*, claim values and applicable policies—were in fact all "pre-settlement" decisions which defined the negotiating framework that led to the settlement itself and in turn formed the basis for USF&G's allocation and reinsurance bill. If reinsurers were permitted to challenge the underlying compromises and coverage

decisions integral to a settlement, no case would ever settle because cedents would be forced to litigate to judgment every issue with their policyholders to prevent reinsurers from contesting—as these Reinsurers do—every strategy decision and compromise that led to a settlement and subsequent reinsurance billing.

The settlement arrived at here involved the resolution of a long running California state court insurance coverage dispute affecting tens of thousands of individual asbestos claimants. Initially, the claimants alleged USF&G was liable for as much as $5 billion and eventually made a settlement demand which sought $1.786 billion in compensatory damages alone. USF&G ultimately agreed to pay $987 million to resolve USF&G's disputed obligations under policies USF&G had issued to Western Asbestos Company ("Western Asbestos").

USF&G subsequently billed its reinsurers for some 40% of that settlement—approximately $400 million—and retained approximately $600 million for USF&G's own account. Reinsurers remaining in this case have refused to pay any portion of USF&G's reinsurance claim.[3] A decade of litigation ensued during which Reinsurers received mountains of documentary

[3] Reinsurers American Home, Arrowood Indemnity, Continental Casualty, Continental Insurance, General Fire, Great American Assurance, Great American Insurance, Hanover, Hartford, Providence Washington and TIG, all members of the ECRA pool, have each settled with USF&G.

and testimonial evidence in their efforts to raise (and abandon) one excuse after another to avoid honoring their reinsurance obligations.

In a 28-page detailed opinion, the trial court granted summary judgment to USF&G (and denied Reinsurers' summary judgment motions), rejecting all of Reinsurers' excuses for non-payment. The First Department affirmed the trial court decision in a lengthy opinion. The lone Appellate Division dissent addressed the single, narrow issue of whether USF&G had paid monies to settle bad faith claims. The dissent did not disagree with any other facet of the majority holding and, significantly, did not dispute the legal standard applied by the majority, which Reinsurers insist is the wrong standard. The lower court decisions, which were made on a complete record after years of discovery, were correct and fully supported by the law, including decisions from this Court and myriad others that have consistently articulated the same deferential legal standard of follow the fortunes.

Reinsurers distort and purposefully confuse the standard by contending that follow the fortunes should not apply whenever a reinsurer questions whether the cedent acted in good faith *toward the reinsurer*. However, courts across the country, including New York, hold that settlement compromises by a cedent are afforded great deference and a reinsurer seeking to avoid application of follow the fortunes by claiming bad faith must make an "*extraordinary* showing of a disingenuous or dishonest failure." Far from

making the requisite showing, Appellants can muster only accusation, speculation and innuendo in claiming that USF&G's settlement decisions were part of a collusive scheme to maximize USF&G's reinsurance recovery.

In fact, it is *Reinsurers* who have violated the *reciprocal* duty of utmost good faith toward their reinsured by, among other things, creating a false dichotomy between USF&G's "allocation" and settlement decisions, making specious policy arguments about the supposed inapplicability of follow the fortunes to excess of loss treaties (notwithstanding that the Treaty here contains an express follow the fortunes provision), and leveling irresponsible and unsupportable allegations of fraud and collusion against USF&G and MacArthur alike—all in the service of refusing to honor *any* of their indemnification obligations to USF&G.

Further, if Reinsurers' construction were accepted, reinsurers in every case would be incentivized to argue lack of good faith (as they re-define it). This would have catastrophic consequences for the reinsurance industry, assuring re-litigation in every case at every stage as losses pass up the risk transfer chain from insurer to reinsurer, reinsurer to "retrocessionaire" (a reinsurer's insurer), and so on. Appellants' interpretation of the follow the fortunes doctrine would flood courts with litigation, hindering the reimbursement process in every large mass tort case. In short, Appellants' proposed changes to the law would have a chilling effect on insurance

settlements, encourage litigation to the detriment of policyholders (and the court system), and undermine a crucial mechanism for the distribution of risk among insurers.

Given the importance of safeguarding this critical risk transfer mechanism, courts have uniformly recognized that the standard for recovery by a cedent is purposely low—a cedent need only show that its payment of claims was *arguably* covered by the cedent's policies with its insured. Even the Reinsurance Association of America ("RAA") concedes in its *amicus* brief that a reinsurer must "indemnify its cedent for losses . . . at least *arguably* covered [] under the underlying policies." RAA Br. at 9 (emphasis added). (And RAA is a trade association that advocates *for reinsurers*, and, as RAA admits, its members include Appellants American Re and ACE, who have representatives on RAA's board of directors, including AmRe's current President and Chief Executive Officer who serves as the Chairman of RAA's board.) Applying this standard, the lower courts' rulings are unquestionably correct.

First, Appellants cannot dispute that USF&G's settlement of thousands of individual asbestos claims for $987 million represented an excellent outcome for both USF&G and Reinsurers. USF&G resolved potentially limitless exposure by successfully arguing that certain principles of California law limited the insured to one year of coverage. The parties then vigorously negotiated claim values, which they capped at the $200,000 per

person policy limit, and then applied those values to the claims at issue to arrive at the settlement amount. Reinsurers now attempt, in contravention of the express terms of the Treaty and settled follow the fortunes principles, to second-guess those negotiated compromises and other settlement decisions that led to the settlement amount. Appellants do so by impermissibly throwing back at USF&G some of the very same arguments that were debated and compromised between USF&G and MacArthur in the underlying litigation.

Second, while the underlying plaintiff (as policyholders routinely do) asserted a claim for bad faith against USF&G, the record incontestably supports that USF&G paid nothing for bad faith. Seizing now upon the *lone* Appellate Division dissent *on this single issue*, Reinsurers argue that they should nonetheless be allowed to put USF&G on trial to determine whether some portion of the underlying $987 million settlement should be re-allocated to bad faith. However, *every party* to the underlying settlement testified that USF&G did not pay any monies on account of bad faith. Tellingly, USF&G settled for half the *compensatory* component of MacArthur's settlement demand. The uncontroverted record is that there was zero *payment* for bad faith, and thus, nothing to allocate to such claims.

Third, Reinsurers' attack on USF&G's decision to allocate the underlying settlement payments to the 1959 treaty year is similarly an attack on the settlement itself since USF&G's reinsurance allocation and billing precisely

tracked the framework the settling parties utilized in negotiating the settlement. Applying California law, the settling parties negotiated the settlement on the basis that one—and only one—of the thirteen policies that USF&G allegedly issued could be called upon to respond to each asbestos claim that potentially implicated USF&G's coverage. This was a tremendous concession obtained by USF&G as it prevented the "stacking" of policy limits, which would have exponentially increased USF&G's (and Reinsurers') exposure. Because the settlement covered all claims by anyone exposed to asbestos during the period 1948-1960, only the last policy year provided coverage for all potentially covered claims. And, the last policy year (*i.e.*, the policy incepting July 1, 1959) had the highest available per-claimant limit ($200,000) and this was the limit used to determine USF&G's maximum per claim liability during settlement negotiations. USF&G allocated claims to a single reinsurance treaty in *exactly the same way* USF&G allocated all claims to a single Western Asbestos insurance policy in negotiating the settlement amount.

Finally, Appellants in one fell swoop attempt to eliminate any of their coverage obligations by baselessly asserting that, decades after the Treaty was issued, the parties entered into an oral agreement to increase the Treaty's retention from $100,000 to $3 million per loss. Reinsurers made this argument for the first time six years into the case. Every justice that considered this argument, including the one dissenting justice on the Appellate Division panel,

found no merit to Reinsurers' position. As AmRe itself acknowledged in its statement of undisputed material facts in its summary judgment briefing below, "USF&G is to absorb the first $100,000 in loss from each accident." A848 ¶ 57. Indeed, the Treaty AmRe attached as Exhibit A to its Complaint *unambiguously* states that the retention is $100,000, A795 ¶ 1, and the only endorsements that were ever signed reflecting a retention increase were in relation to later, post-1962 treaties. That Reinsurers on appeal now pretend that the retention was $3 million underscores the lengths to which Appellants have gone to avoid honoring their contractual obligations.

COUNTER-STATEMENT OF QUESTIONS PRESENTED

1. Did the courts below correctly rule that USF&G's settlement decisions and compromises—which Appellants mislabel "post-settlement allocations decisions" on this appeal—were integral to the settlement itself and under follow the fortunes principles may not be second guessed? Answer: Yes.

2. Did the court below correctly hold, in the alternative, that even if it were to consider Appellants' arguments challenging USF&G's settlement decisions on the merits, those challenges did not excuse Appellants of their obligation to follow the settlement fortunes of USF&G or create an issue of fact barring summary resolution? Answer: Yes.

3. Did the courts below correctly rule that Appellants cannot circumvent follow the fortunes by speculating that the settlement was for bad

faith liability when the uncontroverted record evidence from every participant in the settlement is that USF&G made no payment for bad faith and the settlement amount was a fraction of the compensatory damage portion of the policyholder's settlement demand made a month-and-a-half before the settlement agreement was executed? Answer: Yes.

4. Did the courts below properly determine that follow the fortunes principles barred Appellants from challenging USF&G's reasonable and good faith allocation since the allocation to the 1959 treaty year is consistent with how the underlying settlement was negotiated? Answer: Yes.

5. Did the courts below properly determine that isolated parol evidence failed to raise a material issue of fact that could vary the express retention amount in the reinsurance treaty when: (i) the reinsurance treaty plainly and unambiguously states that the retention is $100,000 per loss (as admitted in Appellants' own pleadings); and (ii) there are no endorsements reflecting a retention increase in the relevant treaty? Answer: Yes.

COUNTER-STATEMENT OF THE CASE

I. THE TREATY

The Treaty at issue in this case was in effect from January 1, 1956 through January 1, 1962. A788 ¶ 27. AmRe provided half of the coverage under the Treaty and ECRA, a pool of reinsurers, provided the other half.[4] *Id.*;

[4] AmRe was also a member of the ECRA pool, and therefore provided additional reinsurance under the Treaty as an ECRA pool member.

A794; A823. AmRe, which was the plaintiff in this action before the parties were realigned, attached a copy of the Treaty as Exhibit A to its Complaint against USF&G and its fellow ECRA reinsurers. A794-822.

The Treaty is an indemnity contract, which means that Reinsurers must reimburse a portion of each covered "loss" USF&G pays to or on behalf of its policyholder. Coverage attaches above a stated retention, which USF&G retains for its own account. Under the Treaty, the first $100,000 arising from each covered loss is borne by USF&G, and Reinsurers, in turn, indemnify USF&G for sums USF&G incurs above that amount up to the $3 million per loss limit. A795 ¶ 1; A848 ¶ 57.

The Treaty contains a provision known as a "follow the fortunes" clause, which vests in USF&G sole discretion to resolve disputed coverage issues with respect to its policies and to determine the manner in which claims should be settled and billed:

> All claims in which this reinsurance is involved, when allowed by [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*. . . . . [USF&G] shall have the right to defend, settle, or compromise any such claim, suit or proceeding, and *such action on the part of [USF&G] shall be binding upon the Reinsurers.*

A799 ¶ 6 (emphasis added). Consistent with the principles underlying follow the fortunes—including the goals recognized by this Court of maximizing coverage, fostering settlements, and streamlining the reimbursement process—

the Treaty mandates reimbursement within *48 hours* of USF&G's presentation of the reinsurance bill. *Id.* ¶ 7.

II. USF&G'S WESTERN ASBESTOS LOSSES

A. Western Asbestos/Western MacArthur

The reinsurance claim at issue in this case stems from USF&G's settlement of a coverage dispute with an entity that claimed the right to recover under policies issued to one of USF&G's policyholders, Western Asbestos, which sold, distributed and installed asbestos-containing products.[5] In the 1960s, Western Asbestos dissolved and its business operations were taken over by Western MacArthur Company ("MacArthur"). *Kaminski v. W. MacArthur Co.*, 175 Cal. App. 3d 445, 451, 452-53 (1st Dist. 1985). In the late 1970s, individuals with health-related injuries began suing MacArthur based on alleged exposure to Western Asbestos products. MacArthur argued that it had no responsibility for the product liability of Western Asbestos, but the California Court of Appeal held that MacArthur had successor liability for Western Asbestos' torts. *Id.* at 459.

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[5] While Appellants have repeatedly mischaracterized USF&G as Western MacArthur's insurer, the reinsurance claim at issue in this case stems from USF&G's settlement of its disputed coverage obligation under policies allegedly issued not to Western MacArthur, but to Western Asbestos, a defunct entity through which MacArthur claimed coverage from USF&G.

B. MacArthur Sues USF&G For Coverage Under The Western Asbestos Policies

In August 1993, MacArthur sued USF&G and another insurer in California state court seeking coverage under policies allegedly issued to Western Asbestos. A851. *See Western MacArthur Co. v. USF&G*, No. 721595-7 (Cal. Super. Ct. Alameda County) (the "*MacArthur* Action"). The *MacArthur* Action lasted nine years, and cost USF&G nearly $30 million to defend. A2323 ¶ 3. USF&G raised a number of defenses to MacArthur's claim for coverage, two of which were potentially dispositive:

Standing: As a threshold matter, USF&G argued that MacArthur lacked standing to sue USF&G under insurance policies allegedly issued to Western Asbestos. As the Appellate Division held, this was not only a good-faith coverage defense, but it "found favor with the courts." A30. MacArthur argued that insurance purchased by Western Asbestos transferred to MacArthur by operation of law, but in 1997, the California Court of Appeal held that MacArthur was not entitled to Western Asbestos' insurance. *Gen. Accident Ins. Co. v. Superior Court*, 55 Cal. App. 4th 1444, 1445 (1st Dist. 1997). As this decision unambiguously confirmed, USF&G had no obligations to MacArthur and accordingly was justified in not defending or indemnifying MacArthur. While Reinsurers improperly accuse USF&G of bad faith in not defending MacArthur, Reinsurers undoubtedly would have cried foul (and refused to indemnify USF&G) had USF&G defended MacArthur after its standing defense

was *upheld* by the 1997 Court of Appeal ruling. In all events, USF&G's decision to argue that MacArthur lacked standing was a reasonable coverage decision which, as a matter of law, Reinsurers may not second guess.

Ultimately, MacArthur entered an arrangement with counsel for the asbestos claimants commencing in the late 1990s whereby MacArthur agreed to have default judgments entered against it in the pending tort litigation in exchange for the asbestos plaintiffs' agreement not to execute on the judgments until the coverage disputes with MacArthur's insurers were resolved. A289-90.

No Products Coverage: Among other defenses to coverage, USF&G argued that its policies, which neither party could locate, did not provide products liability coverage, and even if they did, the policies would have contained aggregate limits on the amount of such coverage. A859-80.

III. TRIAL OF THE *MACARTHUR* ACTION

The *MacArthur* Action was tried in phases. Jury trial of the first phase commenced in March 2002, A2468 ¶ 2, and addressed the terms and conditions of coverage, including the extent to which MacArthur had any rights under the policies issued to Western Asbestos. A881-82.[6] MacArthur initially sought more than $5 billion from USF&G. A2468 at ¶ 2.

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[6] Reinsurers are incorrect when they claim that the issue of bad faith was the focus of Phase I. After determining the terms and conditions of coverage and the validity of the assignment of insurance rights between Western Asbestos and MacArthur, the court would apply the terms of the insurance coverage to the underlying claims in

Prior to the trial of the *MacArthur* Action, MacArthur sought to escape the 1997 California appellate decision with respect to the standing issue by purporting to resurrect the then-defunct Western Asbestos for the purpose of assigning its insurance rights to MacArthur. MacArthur found a former Western Asbestos officer and arranged for him to sign an assignment of insurance rights to MacArthur. A921-27. MacArthur also convinced a California court to "revive" Western Asbestos after the fact to ratify the assignment. A904 at ¶ 38; A929-933. Thereafter, Western Asbestos intervened in the *MacArthur* coverage action as a co-plaintiff. A891. During Phase I, USF&G argued that the assignment and ratification were unenforceable, A1702-05, but the trial court rejected this defense mid-trial, ruling by order dated April 19, 2002 that USF&G lacked standing to challenge the purported assignment of insurance rights to MacArthur. A1709-11. This ruling was a significant set-back for USF&G.

With respect to the terms of coverage, MacArthur presented secondary evidence that USF&G's (lost) Western Asbestos policies provided products coverage without aggregate limits. A1713-19 at 91:18-97:22. If USF&G's policies were found to have no aggregate limits, USF&G's potential liability could have been (in the words of AmRe) "astronomical." A936; *see*

Phase II. A881-83. The issue of bad faith, which Reinsurers falsely suggest was the focus of Phase I, was not to be addressed, if at all, until Phase III of the trial.

also A938 (AmRe memo noting that "[a]lthough USF&G has several available coverage defenses, the downside exposure potential is enormous" and, under such a scenario, Reinsurers' "liability to USF&G is probable").

The *MacArthur* Action settled shortly after these adverse developments near the end of the first phase of the trial. A414-20.

IV. THE SETTLEMENT

USF&G, MacArthur, and the asbestos plaintiffs' lawyers who were prosecuting the underlying tort claims against MacArthur engaged in global settlement discussions throughout the trial to negotiate a lump sum settlement amount. David McClain, counsel representing the asbestos plaintiffs, was one of the individuals primarily responsible for negotiating with USF&G's representatives. A2382; A2605 at 176:3-16. Mr. McClain later described the settlement negotiations as "hard fought." A2384 ¶ 6. MacArthur's counsel concurred: "[T]his was a difficult negotiation, particularly towards the end. Nobody held a party afterwards." A943 at 96:2-4.

During the negotiations, the asbestos plaintiffs asserted that MacArthur faced more than $5 billion in liability and that USF&G owed coverage for more than $2 billion of that exposure. A2383 ¶ 5; A2468 ¶ 2; A1727-28 at 177:10-178:7. With its coverage defenses, including its once successful (and dispositive) no standing defense, eroded after many years of costly and complex litigation, and facing the specter of having to insure

MacArthur's multi-billion dollar liability to asbestos plaintiffs, USF&G ultimately settled for approximately $987 million. A2470 ¶ 6.[7]

A written settlement agreement was executed on June 3, 2002 (the "Settlement Agreement"). A377-422. Consistent with the evidence adduced at trial, the parties stipulated that between 1948 and 1959 USF&G had issued thirteen general liability policies to Western Asbestos. The coverage varied by year with the later years providing the highest limits. No policy had higher per person or per accident limits than the last policy, which covered the period July 1, 1959 through July 1, 1960 and had per person limits of $200,000. A416-17 ¶ 7.

A. Claim Numbers And Values

In negotiating the settlement, each side agreed to: (i) treat each asbestos claim as a separate accident for purposes of assessing MacArthur's total potential liability; and (ii) cap each underlying asbestos claim at $200,000, which was the per person limit under the last of the underlying policies, *i.e.*, the 1959 policy. A2469 ¶ 5; A2471 ¶ 10; A2384 ¶ 7(a) & (d).

In valuing default judgments during settlement negotiations, each default judgment triggering USF&G's coverage was capped at the $200,000 per person policy limit. A2471 ¶ 10. In other words, if an asbestos claimant had a

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7 Tellingly, this was $163 million *less* than the $1.15 billion settlement reached by ECRA pool member Hartford, which (unlike USF&G) had issued direct insurance policies to MacArthur. A1742 § 3.1.

million dollar default judgment, USF&G paid only $200,000 on behalf of that individual.[8]

To establish USF&G's exposure for pending and future claims, the parties retained experts and exchanged data to determine the number of past, present and future claimants, the type of disease suffered in each claim, and the dollar value of the injuries. A2469 ¶ 5; A2383-84 ¶¶ 4, 7(c). The various asbestos-related injuries were assigned the following dollar values:

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

A2470-71 ¶ 9; A2384 ¶ 7(c). USF&G's overall liability on account of such claims was then calculated by multiplying the expected number of claimants in each category by the value assigned to the claim capped at $200,000 (the per person limit of the later policies). A2471 ¶ 10; A2383-84 ¶¶ 4, 7.

B. Allocation To 1959 Policy Year

The asbestos plaintiffs argued that under California's continuous injury theory of coverage, all policies between a claimant's first exposure to asbestos and death potentially are "triggered."[9] A2472. This meant that a

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8 Accordingly, Reinsurers' repeated statements that USF&G made extra-contractual payments above and beyond the limits of the insurance policies as a result of default judgments is demonstrably false and has *no* support in the record.

9 *See Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co.*, 45 Cal. App. 4th 1, 43 (1st Dist. 1996).

claimant could claim coverage under *every* policy in existence during the protracted period of injury.

Next, the claimants contended that under California's "all sums" rule, if a policy is "triggered," the insurer that issued the policy must pay the *entire* amount of a claimant's injuries up to the per person policy limit, not merely the liability allocable to the portion of injury happening during the particular policy period in question. A2384 ¶ 7(d). And to the extent any given policy year's per person limit precluded recovery of a claimant's full measure of damages, the asbestos claimant could stack its available policy limits and recover the balance of its damages under any other policy or policies implicated by the "continuous trigger," cherry picking the policies with the highest per person limits. Thus, USF&G's counterparties sought to combine the continuous trigger theory and the "all sums" rule to create an *enormous* exposure for USF&G, particularly given MacArthur's contention that the underlying policies had no aggregate limit. RA248-49 at 223:8-24; 224:6-17.

In negotiating the settlement, USF&G mitigated the effect of the "all sums" rule by successfully arguing that, under "anti-stacking" principles, the limits of successive policies triggered by a single claim could not be effectively aggregated—or "stacked"—to increase the available coverage. A2470 ¶ 8; A2384 ¶ 7(d); A1810-11 at 226:12-227:4; A1824-26 at 157:19-159:6. *See FMC Corp. v. Plaisted & Cos.*, 61 Cal. App. 4th 1132,

1182-90 (6th Dist. 1998). Rather USF&G argued, and ultimately the parties settled on the basis that, any one claimant's injury would be covered under only a *single* policy, thereby significantly reducing USF&G's (and derivatively, Reinsurers') exposure. A2470 ¶ 8; A2384 ¶ 7(d). Prevailing on this point in the negotiations meant that USF&G's liability to any particular asbestos claimant was necessarily limited to the highest amount of coverage available under a *single* policy. In this way, USF&G was able to resolve the *MacArthur* Action for significantly less than initially demanded.[10]

During settlement negotiations, the parties agreed that USF&G's liability for each asbestos claim was capped at $200,000, the higher per person limit of the later policies. A2471-72 ¶¶ 10, 14; A2473; A2384 ¶ 7(d). Since all asbestos claims were resolved as part of the settlement and since (under a continuous trigger) only the last policy year (*i.e.*, July 1, 1959) would encompass all claims for anyone exposed to asbestos during the settled period, A2471-72 ¶ 14, USF&G "allocated all of its settlement payments made pursuant to the Settlement Agreement to the underlying Western Asbestos policy that incepted on July 1, 1959." *Id.*

[10] Since the settlement, one California appellate court has held that policyholders *can* stack limits. *See California v. Cont'l Ins. Co.*, 88 Cal. Rptr. 3d 288, 301-02, 313 (4th Dist. 2009), *appeal pending to Cal. Sup. Ct.*, 91 Cal. Rptr. 3d 106 (2009). This subsequent legal development underscores USF&G's tremendous accomplishment in limiting its (and hence Reinsurers') exposure to only a single policy period.

C. No Payment For Bad Faith

Reinsurers baselessly claim that USF&G settled $1.25 *billion* of underlying bad faith claims against it. AmRe Br. at 1. In reality, on April 19, 2002, MacArthur made a $1.953 billion settlement demand that included only $167 million (less than *10%* of the total amount) for purported bad faith liability. A2480. However, USF&G steadfastly refused to pay any amount for MacArthur's bad faith claim, A2385 ¶ 9, and ultimately was able to reach a settlement for $987 million, a mere fraction of the $1.786 billion *compensatory* damages component of the demand. The parties to the underlying Settlement Agreement (*i.e.*, representatives of USF&G, the asbestos plaintiffs and MacArthur) have *all* confirmed under oath, in the context of discovery *in this case*, that no portion of the settlement amount was in respect of USF&G's alleged bad faith liability. A2471 ¶¶ 12-13; A2384-85 ¶¶ 6, 9; A1727 at 177:4-8; A2392 ¶ 15.

D. Judgment Escrow/Bankruptcy Trust

Under the Settlement Agreement, USF&G paid certain monies into an escrow account (the "Judgment Escrow"), which was to be used to pay a portion of the default judgments that had previously been entered against MacArthur. A383-84 § 3.1(a).[11] As further contemplated by the Settlement Agreement, the MacArthur entities filed for bankruptcy protection and sought

[11] Once USF&G paid monies into the Judgment Escrow, USF&G had no control over Judgment Escrow distributions. A2483 ¶ 6; A2486-87 § 4(a).

an injunction barring all future claims against both MacArthur and USF&G, in exchange for the creation of a trust fund (the "524(g) Trust") for the additional compensation of existing and future asbestos claimants.[12] *See* 11 U.S.C. § 524(g). On February 3, 2004, the U.S. Bankruptcy Court confirmed the reorganization plan and held that the Settlement Agreement was made "in good faith as a matter of law." A220.

V. USF&G'S REINSURANCE CESSION

After the settlement, USF&G billed AmRe and ECRA, each of which provided 50% of USF&G's reinsurance coverage under the Treaty, for their share of the loss. A2349-77.[13] USF&G billed Reinsurers approximately

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12 The trust began paying claims in April 2004. USF&G has no control over trust distributions, which are determined under court-approved procedures that USF&G neither drafted nor approved. A1832 at 596:4-15; A1834 at 671:18-25; 673:8-10; A1836-39 at 121:11-124:5; A1726 at 154:10-12; A1846-47 at 68:22-69:9; A2471 ¶ 13.

13 Appellants suggest it was improper that USF&G's outside counsel began drafting a complaint against AmRe before the bill was presented to Reinsurers. AmRe Br. at 4, 23. Appellants cannot seriously contend that this results in forfeiture of USF&G's reinsurance. To put this in context, AmRe had coverage counsel in place throughout the underlying case, considered and ultimately elected not to associate with USF&G in the defense, and then retained outside litigation counsel during this same pre-bill time period. A1044; A1102; A1103; A1105 at 199:15-18. In fact, AmRe withheld documents (created before USF&G issued its bill) from production in this action because AmRe purportedly anticipated litigation with USF&G. RA350-389; RA390-395; RA396 ¶ 2. Accordingly, USF&G was right to assume that AmRe was gearing up for litigation. In addition, USF&G reasonably anticipated litigation based on its prior course of dealing with AmRe (having previously been forced into litigation before AmRe finally paid a prior claim under the Treaty, RA484-91) and based on AmRe's "reputation" of "not paying claims" "fast or easily or willingly." RA398-99 at 283:14–285:22.

$400 million, 40% of USF&G's out of pocket payments.[14] *Id.*; A2322-27. The reinsurance cession mirrored in all respects the rationale of the underlying settlement. A2347 ¶ 6; A1809-11 at 225:13-227:19.

A. Claim Numbers And Values

In preparing the reinsurance cession, USF&G used the number of claimants and values that derived from the parties' settlement negotiations, and then deducted $100,000 for each claimant's injury, retaining for itself the per loss Treaty retention. A2347 ¶¶ 7-9. For past claims, the amount of a tort claimant's actual judgment to be paid by USF&G was capped at the $200,000 policy limit, and only the portion of that figure that exceeded the $100,000 Treaty retention was ceded to Reinsurers. *See* A2347 ¶ 8; A2358-60; A2370. Thus, for any default judgment that exceeded $100,000, USF&G was out of pocket $100,000.

For present and future claims, Reinsurers were not responsible for injuries that the parties valued at less than the $100,000 per loss retention in the Treaty.[15] The two types of asbestos injuries valued by the parties above $100,000 were lung cancer (valued at $200,000) and mesothelioma (valued at $500,000, but capped at the $200,000 per person policy limit). A2470-71 ¶ 9;

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[14] USF&G has entered into settlements with a number of ECRA pool members. *See supra* note 3. Reinsurers remaining in this case owe approximately $250 million in principal. A53-56.

[15] For settlement purposes, asbestosis claims were valued at $50,000, pleural claims at $20,000 and other cancers at $20,000. A2384 ¶ 7(c); A2470-71 ¶ 9.

A2384 ¶ 7(c). In preparing the reinsurance bill, USF&G retained for itself half of the $200,000 limit for each lung cancer and mesothelioma claim (to satisfy the $100,000 Treaty retention) and ceded to Reinsurers only the other half. A2347 ¶¶ 8-9.

B. Allocation To 1959 Treaty Year

Again, applying "all sums" and "anti-stacking" principles, the parties to the underlying Settlement negotiated that one—*and only one*—USF&G policy could be called upon to respond to any particular asbestos claim. *See* A2470 ¶ 8; A2384 ¶ 7(d); A1810-11 at 226:12-227:4; A1824-26 at 157:19-159:6. Because the last policy year (*i.e.*, the policy incepting in July 1, 1959) had the highest available limit, and only that last policy year would (given the continuous trigger theory) encompass all claims for anyone exposed to asbestos during the settled period, USF&G allocated all of its Settlement payments to the underlying Western Asbestos policy that incepted on July 1, 1959. A2471-72 ¶ 14.

When preparing its reinsurance cession, USF&G tracked the underlying settlement and similarly allocated USF&G's losses to the 1959 Treaty year consistent with USF&G's usual practice of following the rationale of the direct settlement. A2348 ¶ 11.

C. No Allocation For Bad Faith

USF&G allocated no portion of the underlying settlement to MacArthur's bad faith claims because (as the record uniformly confirms) USF&G did not pay any consideration on behalf of such claims.[16] A2471 ¶¶ 12-13; A2384-85 ¶¶ 6, 9; A1727 at 177:4-8; A2392 ¶ 15. Accordingly, the fact pattern here is nothing like that in the third hypothetical posited by AmRe (AmRe Br. at 15-16) where a cedent (unlike USF&G) pays monies on account of its policyholder's extra-contractual bad faith claims as part of a lump sum settlement but then for reinsurance purposes does not allocate any amounts to bad faith. Rather, the reinsurance cession comports with AmRe's second hypothetical (*i.e.*, settlement for amount above treaty retention) where AmRe admits "it is in no way unjust for the reinsurer to be bound to make payment under the follow-the-fortunes doctrine without being able to challenge the underlying merits." AmRe Br. at 14-15.

VI. PROCEDURAL HISTORY AND DECISIONS BELOW

A. Reinsurance Litigation

In 2002, AmRe commenced this action against USF&G, ECRA, ECRA's agent Excess and Treaty Management Corporation ("ETMC"), and the

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[16] Reinsurers' repeated argument that USF&G's settlement resolved $1.25 billion of extra-contractual bad faith claims (AmRe Br. at 1) is a complete fabrication and is contrary to the uncontroverted record. Reinsurers are misleadingly equating the amount of each default judgment entered against MacArthur above the $200,000 per person limit as a bad faith claim against USF&G, AmRe Br. at 19, 31-32, even though USF&G successfully negotiated otherwise in its settlement—capping the amount of each default judgment at the $200,000 per person policy limit.

individual ECRA pool members, seeking a declaration of Reinsurers' obligations to USF&G under the Treaty. A783-822. On June 14, 2006, the trial court realigned the parties and USF&G became the plaintiff and Reinsurers the defendants. A967-69.

Throughout this litigation, Reinsurers have repeatedly asserted and then abandoned a litany of defenses to USF&G's reinsurance claim as part of their ever shifting attempt to avoid their contractual obligations. For example:

- In its motion for partial summary judgment, AmRe improperly attacked the settlement *solely* based on post-settlement distribution decisions by the bankruptcy trustee, a position it since disavowed in the Appellate Division and has now abandoned. A84-85.
- AmRe stated in its summary judgment briefing below that the $100,000 Treaty retention was an *undisputed* material fact. A82-86; A848 ¶ 57. In addition to totally abandoning its principal argument made below, AmRe now ignores its own internal documents to the contrary and claims that the parties orally agreed to increase the retention to $3 million, without even acknowledging its prior binding admission.
- ECRA no longer is pursuing its argument below that multiple individual accidents should be grouped together as a single loss, A98, but has taken up for the first time in *this* court, AmRe's abandoned argument about post-settlement distributions by the trustee.

It also is noteworthy that, despite demanding thousands of documents and taking scores of depositions, the arguments of Reinsurers and their new counsel concerning the underlying settlement negotiations are based

solely on innuendo and speculation (which, of course, do not constitute genuine issues of *fact* to defeat summary judgment).[17] By contrast, USF&G relies on the unrebutted record, including uncontroverted sworn testimony by each party to the underlying Settlement Agreement (USF&G, asbestos plaintiffs and MacArthur). *See*, *e.g.*, A2468-80; A2382-86; A2389-93.

B. The Trial Court Decision

Both USF&G and Reinsurers individually moved for summary judgment. On August 17, 2010, the trial court granted USF&G's motion and denied Reinsurers' motions in a well-reasoned 28-page decision and order. A73-101.[18] The trial court held that Reinsurers' various challenges to the manner in which USF&G had settled the Underlying Action were precisely "the kind of re-litigation that the follow the fortunes doctrine is designed to avoid." A85. The trial court also held that Reinsurers had not presented any admissible evidence that "a portion of the settlement amount was attributable to [MacArthur's] bad faith claim." A95.

Finally, the trial court rejected Reinsurers' argument that the parties orally agreed to increase the retention amount in the pre-1962 Treaty at

[17] Wachtell Lipton and Boies Schiller did not become counsel in this case until after the trial court granted summary judgment for USF&G. Quinn Emanuel substituted in as counsel in August 2007, five and half years after the commencement of this action and after AmRe's motion for partial summary judgment was fully briefed.

[18] By Order dated October 22, 2010, the trial court corrected certain clerical errors and made certain clarifications to the August 17, 2010 Order. A57-58. On October 25, 2010, Judgment was entered against AmRe, ECRA and the non-settling individual pool members. A53-56.

issue from $100,000 to $3,000,000. The trial court held that: (i) "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" and (ii) "the parties only drafted and signed policy endorsements increasing the retention of post-1962 reinsurance treaties." A89, A93. As such, the parol evidence rule barred consideration of the extrinsic evidence offered to vary the unambiguous contract terms. Moreover, although Reinsurers had not pled a reformation claim, the Court reviewed the record and determined there was no issue of fact sufficient to sustain reformation under the applicable standard for mutual mistake or fraud (*i.e.*, clear and convincing evidence). A93.

C. The Appellate Division Decision

In a comprehensive 21-page opinion, the Appellate Division, in a 4 to 1 decision, affirmed the trial court's ruling in its entirety. The Appellate Division held that "the follow-the-fortunes doctrine required defendants to accept the reinsurance presentation made by USF&G," and that "all of defendants' efforts to second guess USF&G's decisions concerning allocation of the loss . . . are precluded from this court's review." A28. The First Department further held that even if it were to consider Reinsurers' arguments on the merits, it "disagree[d] that they excused the reinsurers from their obligation to follow the fortunes of USF&G or created an issue of fact barring summary resolution." *Id*. Finally, the Appellate Division *unanimously* held

that "the motion court correctly concluded that the retention increase to $3 million was limited to those claims submitted under the 1962 to 1967 treaty and later treaty years," and that the retention in the pre-1962 Treaty at issue was $100,000. A24-25.

The lone dissent in the Appellate Division was limited to one narrow issue. The dissent believed there was a "genuine triable issue of fact as to whether a portion of the $987.3 million settlement that [USF&G] reached with [MacArthur] was for bad faith claims." A35.

ARGUMENT

I. THE COURT SHOULD REJECT APPELLANTS' ATTEMPT TO DISTORT THE FOLLOW THE FORTUNES DOCTRINE BEYOND RECOGNITION AND DENUDE IT OF ANY FORCE AND EFFECT

Reinsurers seek to alter the bedrock principle of reinsurance law that reinsurers must "follow the fortunes" of their reinsureds. As the Appellate Division correctly noted, this principle is "as old as the business of reinsurance itself." A26. Follow the fortunes binds a reinsurer "to accept the cedent's good faith decisions on all things concerning the underlying insurance terms and claims against the underlying insured: coverage, tactics, lawsuits, compromise, resistance or capitulation." *Allstate Ins. Co. v. Am. Home Assur. Co.*, 43 A.D.3d 113, 121 (1st Dep't 2007); *see also Travelers Cas. & Sur. Co. v. Certain Underwriters at Lloyd's of London*, 96 N.Y.2d 583, 596 (2001) ("*Lloyd's*") ("A reinsurer cannot second guess the good faith liability

determinations made by its reinsured, or the reinsured's good faith decision to waive defenses to which it may be entitled."). This includes allocation decisions made by a ceding company. *Allstate*, 43 A.D. 3d at 121 ("the cases unequivocally hold that the [follow the fortunes] doctrine extends to a post-settlement allocation").

This Court recognized a decade ago that follow the fortunes "maximiz[es] coverage and settlement" by "preventing a reinsurer from continually challenging the propriety of a reinsured's settlement decision." *Lloyd's*, 96 N.Y.2d at 596 (citing *Int'l Surplus Lines Ins. Co. v. Certain Underwriters & Underwriting Syndicates at Lloyd's of London*, 868 F. Supp. 917, 921 (S.D. Ohio 1994)); *see also CIGNA*, 52 F.3d at 1205 ("'Follow the fortunes' doctrine protects the risk transfer mechanism by providing that covered losses pass uninterrupted along the risk transfer chain."). As the Southern District of Ohio (on whose decision this Court relied in *Lloyd's*) observed:

> Were the Court to conduct a de novo review of [the insurer's] decision-making process, the foundation of the cedent-reinsurer relationship would be forever damaged. The goals of maximum coverage and settlement that have been long established would give way to a proliferation of litigation. Cedents faced with de novo review of their claims determinations would ultimately litigate every coverage issue before making any attempt at settlement.

Int'l Surplus, 868 F. Supp. at 921; *see also CIGNA*, 52 F.3d at 1206 (quoting same); *Commercial Union Ins. Co. v. Seven Provinces Ins. Co*., 9 F. Supp. 2d 49, 66 (D. Mass. 1998), *aff'd*, 217 F.3d 33 (1st Cir. 2000) ("If the ceding company knew that its settlement decisions could be challenged by every reinsurer, there would be little incentive to settle with the insured.").

By taking away the ability of reinsurers to second guess underlying claims handling and settlement decisions, follow the fortunes enables insurers to efficiently share and spread the risk of exposure among themselves, ultimately facilitating more expansive coverage for the policyholder. As courts have uniformly recognized, because (as here) allocation decisions are so often inextricably intertwined with the claims handling and settlement processes, the follow the fortunes doctrine applies equally to allocation decisions. *See Seven Provinces*, 9 F. Supp. 2d at 67 ("the attempt to distinguish settlement from allocation would undermine the entire 'follow the settlements' doctrine"); *see also Travelers Cas. & Co. v. Gerling Global Reins. Corp*, 419 F.3d 181, 189 (2d. Cir. 2005) ("[W]e decline to authorize an inquiry into the propriety of a cedent's method of allocating a settlement if the settlement itself was in good faith, reasonable, and within the terms of the policies.").

The second-guessing of the settlement negotiation framework and the resulting allocation that Appellants urge this Court to countenance is "precisely th[e] kind of intrusive factual inquiry into the settlement process, and

the accompanying litigation, that the deference prescribed by the follow-the-settlements doctrine is designed to prevent." *N. River Ins. Co. v. Ace Am. Re-Ins. Co.*, 361 F.3d 134, 141 (2d. Cir. 2004). If accepted, the arguments Appellants advance would thwart the salutary goals of promoting settlement, "maximizing coverage," and "streamlin[ing] the reimbursement process." *Lloyd's*, 96 N.Y.2d at 596.

A. The Lower Courts Applied The Correct Summary Judgment Standard, Properly Taking Account Of The High Bar Required To Rebut The Presumption Of Follow The Fortunes

Under the follow the fortunes doctrine, "summary judgment" for the cedent is "appropriate if payment of the claims [is] *even arguably* within the scope of the policy it issued" to its policyholder. *Nat'l Union Fire Ins. Co. v. Am. Re-Ins. Co*., 441 F. Supp. 2d 646, 650-51 (S.D.N.Y. 2006) (emphasis added); *see also Granite State Ins. Co. v. ACE Am. Re-Ins. Co.*, 46 A.D.3d 436, 439 (1st Dep't 2007) ("[t]he 'follow the fortunes' doctrine requires payment where the cedent's good faith payment is at least arguably within the scope of the insurance coverage that was reinsured"). Consequently, the trial court's summary judgment ruling should be affirmed so long as "[n]o reasonable factfinder could find the payment was not at least arguable." *Nat'l Union*, 441 F. Supp. 2d at 651.

There is nothing novel about the above proposition. Indeed, as this Court recognized in *Lloyd's*, follow the fortunes mandates that a reinsurer

"indemnify for payments *reasonably within* the terms of the original policy, *even if technically not covered by it*." *Lloyd's*, 96 N.Y.2d at 596 (emphasis added). As even the former Vice President of Claims for the U.S. branch office of Munich Re (AmRe's parent) properly recognized:

> "Reasonable," in the Follow the Fortunes context, means sensible, or perhaps more colloquially "not irrational." Under custom and practice, if the ceding company's coverage decision is sensible, not totally unreasonable (*i.e.* arguable or colorable), then the reinsurer must accept the cedant's judgment. Again, *the ceding company must meet a low threshold to satisfy the Follow the Fortunes clause on coverage issues*. To do otherwise would frustrate the goal underlying the Follow the Fortunes clause—swift, unimpeded reimbursement to the cedant.[19]

The doctrine thus obligates a reinsurer to indemnify its reinsured for any payments the reinsured makes—as a result of a judgment or settlement with the insured—for claims "arguably" covered by the underlying policy. *Mentor Ins. Co. (U.K.) Ltd. v. Brannkasse*, 996 F.2d 506, 517 (2d Cir. 1993). "This standard is purposefully low and the decision making process of the ceding insurer is not subject to de novo review." *Nat'l Union*, 441 F. Supp. 2d at 651; *CIGNA*, 52 F.3d at 1206 ("'follow the fortunes' doctrine creates an exception to the general rule that contract interpretation is subject to de novo review").

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[19] Jack Cuff, *Follow the Fortunes: Industry Customs and Practices*, 11 Mealey's Litig. Rep. No. 3 (June 2000), at 33 (emphasis added).

Reinsurers are simply wrong when they claim that the lower courts and USF&G distort the summary judgment standard in this case. *See* AmRe Br. at 51-52; ECRA Br. at 41. The standard is decidedly not whether there is a triable issue as to whether a *de novo* review of USF&G's coverage and settlement decisions might lead to a finding that the coverage and settlement decisions were incorrect. *CIGNA*, 52 F.3d at 1206 ("[A] court or panel, faced with a reinsurer's denial of liability, would ask not whether the underlying claim was covered by the cedent's policy, but whether there is any reasonable basis to conclude there was such coverage.") (citation and internal quotation marks omitted); *Champion Int'l Corp. v. Cont'l Cas. Co.*, 400 F. Supp. 978, 981 (S.D.N.Y. 1975) (a reinsured's good faith coverage determinations do not have to be correct, but only reasonable when made), *aff'd*, 546 F.2d 502 (2d Cir. 1976). The same deference is afforded to allocation decisions. Otherwise, a court risks doing precisely what the follow-the-fortunes doctrine aims to prevent: interfering in the settlement process between insurers and their insureds. *See*, *e.g.*, *Gerling*, 419 F.3d at 189 ("Judicial review of either the settlement decision or the allocation decision 'has an equal likelihood of undermining settlement and fostering litigation.'") (quoting *Seven Provinces*, 9 F. Supp. 2d at 68); *Travelers Cas. & Sur. Co. v. Ins. Co. of N. Am.*, 609 F.3d 143 (3d Cir. 2010) ("A contrary holding [that follow the fortunes does not apply to allocation decisions] would risk doing precisely what the follow-the-fortunes

doctrine aims to prevent—interfering in settlement negotiations between insurers and their insureds . . .").[20]

While Reinsurers urge such a *de novo* review on this Court, it is manifestly improper—as a legion of cases, including those cited above, make clear. Appellants repeatedly accuse USF&G (and the lower courts) of inappropriately shifting the summary judgment burden. Appellants are wrong. There is no question as to the interplay of follow the fortunes and the summary judgment standard—summary judgment was appropriate if there is no triable issue as to whether USF&G's payment of claims is even *arguably* within the scope of the policies it issued. The First Department, mindful of this interplay, properly found that Appellants were unable to "create[] an issue of fact barring summary resolution," as multiple other courts have similarly found. A28; *see, e.g.*, *Gerling*, 419 F.3d at 195 (reversing district court and granting summary judgment in favor of cedent because its allocation "easily meets th[e] deferential standard of review"); *N. River*, 361 F.3d at 136 (finding that district court properly "granted summary judgment for [cedent] and ordered [reinsurer]

[20] Appellants repeatedly invoke *Ins. Co. of N. Am.*, 609 F.3d 143 (3d Cir. 2010), to support their contention that they need not follow USF&G's settlement fortunes here and that summary judgment for USF&G was inappropriate. Reinsurers ignore the Third Circuit's central holdings in that case. The Third Circuit unambiguously held that follow the fortunes "does apply to post-settlement allocations." *Id.* at 158. Indeed, application of follow the fortunes to settlement allocations is so widely accepted that INA (whose successor-in-interest, Century, is one of the Reinsurers here) did not even seek to contest it. *Id.* Moreover, the Third Circuit made clear that there is "no positive duty on the part of the insurer to minimize its reinsurance recovery." *Id.* at 158.

to pay the disputed bill, reasoning that the deferential follow-the fortunes doctrine required [reinsurer] to accept [cedent's] allocation."); *Nat'l Union*, 441 F. Supp. 2d at 648 (granting summary judgment in favor of cedent).

Follow the fortunes creates a presumption in favor of the propriety of a cedent's settlement negotiations and compromises and resulting allocation decisions so long as those decisions were reasonable in the broadest sense—*i.e.*, "sensible", "colorable," and "not irrational." Once a cedent meets this "purposely low standard," the burden shifts to the reinsurer to overcome the presumption by competent evidence. The cases uniformly hold that this burden on reinsurers requires an "*extraordinary* showing." *Gerling*, 419 F.3d at 191(emphasis in original). Reinsurers certainly cannot meet that burden through innuendo, speculation, or even offering another "reasonable" way to settle or allocate a claim. *See* cases *infra* at 73.

B. Adopting Appellants' Stripped Down Version Of Follow The Fortunes Would Discourage Settlements, Create Endless Reinsurance Litigation, And Hinder The Spreading Of Risk

1. Reinsurers' contention that a reinsurer is only bound by its reinsured's "decision to settle" and "the amount of that settlement"—and nothing more—does not comport with either the Treaty language or the purpose of the doctrine

Reinsurers' attempt to limit the applicability of follow the fortunes solely to an insurer's precisely circumscribed "decision to settle" and the "amount of that settlement" threatens to undermine the well-established

rationale behind the doctrine. AmRe Br. at 41. While Reinsurers attempt to paint *Lloyd's* as a restrictive holding with respect to the breadth of the follow the fortunes doctrine, the *only* limitation *Lloyd's* mentions regarding the doctrine's scope is the unremarkable proposition that follow the fortunes does not override express provisions in a reinsurance treaty. *Lloyd's*, 96 N.Y.2d at 596.[21] Indeed, this Court stated, contrary to Reinsurers' cramped reading of *Lloyd's*, that follow the fortunes extended to all "good faith liability determinations" and other underlying coverage decisions, including "the reinsured's good faith decision to waive defenses to which it may be entitled." *Id.* at 596.

The cases following *Lloyd's* have broadly interpreted the doctrine in precisely the same way and make clear that follow the fortunes prevents reinsurers from second-guessing *any* of the insurer's good faith compromises, coverage decisions, and tactics relating to the underlying settlement—not just the insurer's decision to settle or the ultimate settlement amount. *See, e.g.*, *Allstate*, 43 A.D. 3d at 121 (1st Dep't 2007) ("a reinsurer is bound 'to accept the cedent's good faith decisions *on all things concerning* the underlying insurance terms and claims against the underlying insured: coverage, tactics, lawsuits, compromise, resistance or capitulation'") (emphasis added). More

[21] In *Lloyd's*, this Court held that on the specific record in that case, the cedent's aggregation of individual losses as a single "disaster" was inconsistent with the express terms of the treaty (specifically the words "series of")—an issue irrelevant on this appeal. 96 N.Y.2d at 596-97.

importantly, the express language of the follow the fortunes clause in the Treaty at issue here makes the broad scope of that clause abundantly clear: "[*a*]*ll* claims in which this insurance is involved, *when allowed* by [USF&G], *shall be binding upon the Reinsurers. . . .*" A799 ¶ 6 (emphasis added).

If the scope of follow the fortunes were constrained in the way Reinsurers advocate, a reinsurer could *always* get around the follow the fortunes doctrine by not *facially* challenging the ultimate decision to settle or the amount of that settlement but *in effect* doing precisely that by questioning the underlying coverage decisions, compromises and decision-making process that led to the settlement. The reinsurance market would struggle to exist in its current form if the follow the fortunes doctrine did not provide the adequate protections to the ceding insurer when settling with its insured that were contemplated by this Court in *Lloyd's* and myriad other courts before and since. *See*, *e.g.*, *Lexington Ins. Co. v. Clearwater Ins. Co.*, 2011 WL 3715546, at *3 (Mass. Super. Ct. July 27, 2011) ("[I]t is difficult to imagine how reinsurance transactions could function in the absence of the [follow the fortunes] doctrine, since otherwise, the reinsured could not make a good faith judgment regarding *allocation* of a settlement without being faced with litigation from its reinsurers.") (emphasis added); *CIGNA*, 52 F.3d at 1211 ("the purpose of 'follow the fortunes' [] is to preserve the risk transfer mechanism" and without the doctrine "reinsureds would be in the impossible position of advancing

defenses in coverage contests that could be used against them by reinsurers seeking to deny liability"); *Nat'l Union*, 441 F. Supp. 2d at 652 ("To allow reinsurers to second-guess [the propriety of a reinsured's allocation] would be to make settlement impossible and reinsurance in itself problematic.") (quoting *Gerling*, 419 F.3d at 189); *Int'l Surplus*, 868 F. Supp. at 921 ("Were the Court to conduct a de novo review of [cendent's] decision-making process, the foundation of the cedent-reinsurer relationship would be forever damaged.").

2. Reinsurers' request to exclude *allocation* decisions from the follow the fortunes doctrine would undermine settlement and foster litigation

In addition to trying to corral the scope of follow the fortunes solely to the "decision to settle" and "the amount of that settlement," Reinsurers also argue that follow the fortunes should never extend to post-settlement allocations—or at the very least—that any application should be severely limited and subject to considerable (newly created) exceptions. This argument is without merit for several independent reasons.

First, as an initial matter, Reinsurers seek to change existing law on which cedents rely and under which the insurance industry has been operating for years. Indeed, "the cases unequivocally hold that the [follow the fortunes] doctrine extends to a post-settlement allocation." *Allstate*, 43 A.D. 3d at 121; s*ee also Ins. Co. of N. Am.*, 609 F.3d at 158 ("The majority view, which INA does not contest, is that [follow the fortunes] does apply to post-settlement

allocations. We join those courts here.") (citations omitted); *Gerling*, 419 F.3d at 188 ("a cedent's post-settlement allocation is subject to follow-the-fortunes, regardless of any pre-settlement position taken by the cedent, whether that position is articulated in a pre-settlement risk analysis, or implicit in the settlement with the underlying insured"); *N. River*, 361 F.3d at 141 ("the court holds that the follow-the-settlements doctrine extends to a cedent's post-settlement allocation decisions"); *Seven Provinces*, 9 F. Supp. 2d 49 (same); *Nat'l Union*, 441 F. Supp. 2d 646 (same).[22]

Second, as courts consistently recognize, any "attempt to distinguish settlement from allocation would undermine the entire follow the settlements' doctrine" because "[r]eview of either type of decision has an equal likelihood of undermining settlement and fostering litigation." *Gerling*, 419 F.3d at 187 (quoting *N. River Ins. Co. v. ACE Am. Reins. Co*., 2002 WL 506682). *See also Seven Provinces*, 9 F. Supp. 2d at 67 ("the attempt to distinguish settlement from allocation would undermine the entire 'follow the settlements' doctrine"). Because post-settlement allocations are so often inextricably intertwined with pre-settlement strategies and decisions—as is

[22] Courts have rejected the argument—made by Reinsurers on appeal—that *Lloyd's* "stands for the proposition that follow-the-fortunes does not apply to post-settlement decisions." *See Gerling*, 419 F.3d at 189-90. Indeed, Judge Wesley, who, as an Associate Judge of this Court, was part of the unanimous decision in *Lloyd's*, subsequently joined the Second Circuit and was on the panel that expressly affirmed in *Gerling* that follow the fortunes applies to post-settlement allocations and that *Lloyd's* did not hold otherwise. *Id*. at 190.

manifestly the case here—undertaking an inquiry into "the propriety of a cedent's method of allocating a [good-faith] settlement" would amount to "engaging in precisely the kind of 'intrusive factual inquiry' that the follow-the-fortunes doctrine is meant to avoid." *Gerling*, 419 F.3d at 189; *id*. ("[W]e decline to authorize an inquiry into the propriety of a cedent's method of allocating a settlement if the settlement itself was in good faith, reasonable, and within the terms of the policies."); *Nat'l Union*, 441 F. Supp. 2d at 653 (holding, in granting summary judgment in favor of the cedent, that "[a]n inquiry into the reasonableness of National Union's post-settlement allocation is . . . inappropriate in light of [*Gerling*]"). USF&G's consistent application of the *very same* allocation decisions and analysis it made *pre-settlement* to its *post-settlement* presentation to Reinsurers lies squarely within the ambit of follow the fortunes.

While Reinsurers persist in arguing—again, without basis—that USF&G's allocation is tainted because USF&G played by "two sets of rules," *Allstate*, 43 A.D.3d at 120, the First Department, including two justices who participated in the *Allstate* decision, directly addressed and summarily dismissed Reinsurers' comparison between *Allstate* and this case. A33 (noting "that the defendants' repeated invocation of this Court's prior decision in [*Allstate*] is unavailing" because "[t]he facts of that case are inapposite to the facts herein").

Third, contrary to Appellants' hyperbolic suggestion, the lower court decisions do not change the legal landscape on follow the fortunes. New York courts routinely apply the standard Appellants themselves agree is applicable in assessing reinsurance claims—*viz*. the reasonableness and good faith standard recognized and applied by *Lloyd's*. Depending on the circumstances, the application of this standard may cut in favor of the cedent or the reinsurer. For example, the Appellate Division ruled in favor of the reinsurers in *Allstate*, 43 A.D.3d 113, and for the cedent in this case, applying the same well-settled legal standard.[23] The notion that the lower courts created novel legal rules for applying follow the fortunes that would forever insulate a cedent's settlement and allocation decisions from judicial review is just alarmist rhetoric.

3. Appellants' argument regarding the doctrine of utmost good faith would create an exception that would swallow the rule and is a backdoor attempt to eviscerate the follow the fortunes doctrine

In an effort to avoid application of the follow the fortunes doctrine, both AmRe and ECRA frame their arguments on appeal as challenges to USF&G's purported failure to comply with its "strict duty" of "utmost good faith" to its reinsurers—a duty they fail to note is reciprocal. AmRe Br. at 47; ECRA Br. at 34. Using their unilateral framework, Reinsurers argue that the

[23] In fact, two of the justices on the Appellate Division majority in this case—Justices Tom and Saxe—ruled in favor of the reinsurer in *Allstate*.

correct summary judgment standard is whether there is any issue of fact as to whether USF&G's settlement decisions were "reasonable" and in the "utmost good faith." AmRe Br. at 47, 54-60. But Appellants read out the deference afforded to an insurer's settlement decisions by the follow the fortunes doctrine—that the propriety of such decisions need only be "arguable or colorable"—and urge the Court instead to apply a *de novo* standard in evaluating USF&G's good faith. Appellants' attempts to leverage the duty of utmost good faith in order to justify the very second-guessing that is barred by the follow the fortunes doctrine constitutes an end-run around the actual "reasonableness and good faith" standard that the courts, including this Court, uniformly recognize applies.

Contrary to Reinsurers' confected and entirely unsupported interpretation of the duty of utmost good faith, the relevant case law holds that the actual duty of good faith owed by the cedent[24] to its reinsurer does not vitiate the reinsurer's obligation to follow the settlement fortunes of the cedent:

> [Reinsurer] seeks a very broad interpretation of the duty [of utmost good faith], akin to a fiduciary duty, but the notion that such a fiduciary duty exists between a ceding insurer and a reinsurer was expressly rejected by the court in *Christiania Gen'l Ins. v. Great American Ins.*, 979 F.2d 268, 280 (2d Cir. 1992). The broad interpretation of the 'utmost

[24] A cedent's duty of utmost good faith typically arises in the context of obtaining reinsurance. *See In re Liquidation of Union Indem. Ins. Co.*, 89 N.Y.2d 94, 106 (1996) (a cedent must "disclose to potential reinsurers all 'material facts' regarding the original risk of loss").

> good faith' standard sought by [reinsurer] would result in complete 'second guessing' of the ceding insurer's decision making that the follow the settlements doctrine was intended to prevent.

Riunione Adriatica di Sicurta v. Atlanta Int'l Ins. Co., No. 601722/97, slip op. at 4 (Sup. Ct., N.Y. County Sept. 17, 1998); *see also United Fire & Cas. Co. v. Arkwright Mut. Ins. Co*., 53 F. Supp. 2d 632, 642 (S.D.N.Y. 1999) ("[u]tmost good faith also requires a reinsurer to indemnify its cedent for losses that are even arguably within the scope of the coverage").

Moreover, the courts have consistently held that "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 . . . ." *Gerling*, 419 F.3d at 191 (quoting *CIGNA*, 52 F.3d at 1216). The standard is "not mere negligence but gross negligence or recklessness." *In re Liquidation of Midland Ins. Co*., 2008 WL 151786, *15 (Sup. Ct., N.Y. County Jan. 14, 2008). *See also Unigard Sec. Ins. Co. v. N. River Ins. Co.,* 4 F.3d 1049, 1069 (2d Cir. 1993) ("[T]he proper minimum standard for bad faith should be gross negligence or recklessness."); *Nat'l Union*, 441 F. Supp. 2d at 653 (rejecting AmRe's identical argument that "summary judgment [was] inappropriate because there is evidence from which a reasonable factfinder could find [the insurer] acted in bad faith with respect to [AmRe's] interests" because AmRe failed to make "the 'extraordinary' showing of bad faith required to avoid application of the follow the fortunes doctrine").

Reinsurers attempt to water down the standard required to show a cedent's bad faith toward its reinsurer precisely because they are unable to meet the more demanding actual standard. Applying the *correct* standard, it is clear, as the lower courts held, that all of Reinsurers' challenges to USF&G's settlement decisions must fail and that summary judgment was appropriate.

Finally, Appellants ignore that the duty of utmost good faith is reciprocal and is owed both by cedents and their reinsurers to one another. *Arkwright*, 53 F. Supp. 2d at 642 ("The duty of utmost good faith is a mutual one; it is an obligation of the reinsurer as well as of the cedent."). Reinsurers utterly disregard *their* duty of utmost good faith by improperly questioning USF&G's settlement decisions, insisting on alternative allocations, and raising a "moving target . . . of constantly shifting defenses and objections to payment." *Seven Provinces*, 9 F. Supp. 2d at 64-65.

II. THE DECISIONS BY USF&G THAT APPELLANTS DENOMINATE "POST-SETTLEMENT ALLOCATION DECISIONS" WERE *ALL* INTEGRAL TO THE SETTLEMENT ITSELF AND UNDER FOLLOW THE FORTUNES PRINCIPLES MAY NOT BE SECOND-GUESSED

Appellants' attacks on what they mischaracterize as post-settlement allocation decisions "are in actuality attacks on the settlement" itself. *Seven Provinces*, 9 F. Supp. 2d at 67. As outlined above, *see supra* pp. 17-23, the underlying settlement was the culmination of a series of compromises by all parties on a host of interconnected disputed issues following nearly nine years

of hard-fought litigation. In a case in which USF&G faced multi-billion dollar liability for thousands of claims, Reinsurers improperly seek to cherry-pick specific USF&G compromises and second guess them. Regardless of what labels Reinsurers attach to those decisions, however, the reality is that they were all integral to the underlying settlement and the result of interrelated negotiations on a multitude of issues. Each of these decisions constituted an essential thread in the tapestry of a complicated settlement process. Reinsurers ignore the core truth that removing any one of those threads would have unraveled the settlement. As courts have recognized, "[m]ost settlements of complex environmental claims necessarily involve a number of [interrelated decisions]" which "are issues of judgment that the reinsured must be allowed to make." *Seven Provinces*, 9 F. Supp. 2d at 68. Without each of the compromises negotiated by USF&G, the underlying settlement would not exist.

Contrary to Appellants' myopic view of follow the fortunes, courts have consistently recognized that the doctrine does not apply to individual decisions in isolation, but to an entire "decision-making process." *Int'l Surplus Lines Ins. Co.*, 868 F.Supp. at 921. Appellants' challenges to USF&G's settlement decisions amount to a wholesale second-guessing of this process. Were Appellants allowed to do so, "the foundation of the cedent-reinsurer

relationship would be forever damaged." *Id*. Reinsurers are simply not permitted to relitigate those settlement compromises.

A. Reinsurers' Challenge Of The Valuation Of Lung Cancer Claims Is An Impermissible Attempt To Relitigate A Settlement Compromise

The uncontroverted testimony of every settlement party is that as part of their compromise, the parties valued pending and future lung cancer claims at $200,000 for settlement purposes. *See* A2470-71 ¶ 9; A2384 ¶ 7(c). Moreover, the Case Valuation Matrix subsequently approved by the Bankruptcy Court for the payment of claims by the 524(g) Trust states that the average settlement value for lung cancer claims in California is $199,195, which shows the reasonableness of USF&G's $200,000 settlement compromise. RA7-25; RA4 at 26:5-13.

Yet, in flagrant breach of their follow the fortunes obligation, Reinsurers contend that it was wrong for USF&G to agree to that valuation because one chart circulated by the asbestos plaintiffs' expert purportedly valued lung cancer claims at $91,174. Reinsurers' second-guessing of the parties' valuation of claims is impermissible under the Treaty, A799 ¶ 6, and settled follow the fortunes principles.

But, *even if* such second-guessing were permissible, Reinsurers are unable to proffer any evidence whatsoever in support of their charge that USF&G "inflate[d]" the value of lung cancer claims to conceal what would otherwise be payment of monies on account of "*un*reinsured extra-contractual

bad-faith claims." AmRe Br. at 23-24. This is a fabrication on the part of Reinsurers, and is contrary to the record. The unrebutted testimony of USF&G's asbestos claims expert is that the chart Reinsurers rely upon did not reflect what the asbestos plaintiffs contended were prevailing settlement values in 2002 for lung cancer claims and included figures that were not the ones used during settlement negotiations:

> [T]his was not, in fact, what the other side demanded in the negotiations. These figures were not the figures . . . they put on the table. They put on the table what they called the law firm values and said that they had gone back to their databases and that they were looking at . . . the most recent couple years and that this was now the neighborhood they were settling in and they would not settle for less.

A2611-12 at 270:18-271:3; *see also* A2711-13 at 64:22-65:14 (the asbestos plaintiffs' counsel "were quite adamant that the values that they were currently settling at in the tort system were the appropriate values to use"); A1724 at 148:23:25 (MacArthur's counsel: "we established to the satisfaction of USF&G" that lung cancer should be valued at $200,000).[25]

Moreover, Reinsurers conveniently ignore that USF&G's counsel used the very same chart now cited by Reinsurers to advocate for lower claim

[25] Reinsurers claim that $91,174 was the highest value for lung cancer claims that the asbestos plaintiffs' expert could "rationally" support. This is pure speculation, and misstates the record. USF&G's expert testified that she did not recall discussing the value of lung cancer claims with the asbestos plaintiffs' expert. A1591 at 263:4-10. *See also* A2612 ("the attorneys really negotiated that, not the experts"). And Reinsurers opted not to take the deposition of the asbestos plaintiffs' expert.

values. A2613-14 at 284:8-285:5. Thus, in addition to second-guessing USF&G's settlement compromises, Reinsurers improperly attempt to use USF&G's underlying coverage arguments against it in clear violation of follow the fortunes. *CIGNA*, 52 F.3d at 1206 (permitting reinsurer to use cedent's coverage defenses against it would place cedent in "untenable position of advancing defenses in coverage contests that would be used against them by reinsurers seeking to deny coverage").

In light of the foregoing uncontroverted evidence in the record, even under a *de novo* standard of review, the notion that there is a triable issue regarding the valuation of lung cancer claims is not supportable. But more fundamentally, Reinsurers are not entitled to *de novo* review of those decisions. Reinsurers' questioning of claim values "is precisely th[e] kind of intrusive factual inquiry into the settlement process, and the accompanying litigation, that the deference prescribed by the follow-the-settlements doctrine is designed to prevent." *N. River*, 361 F.3d at 141.

B. Reinsurers' Argument That They Should Not Have To Indemnify USF&G For Their Share Of Default Judgments Capped By The $200,000 Limit In The Underlying Policies Is Both An Impermissible Attempt To Re-Litigate USF&G's Settlement And An Impermissible Attack On USF&G's Good Faith Standing Defense

As part of the settlement, USF&G paid coverage on account of default judgments that had been entered against MacArthur. *See*, *e.g.*, A383-84 § 3.1(a). The settling parties agreed that regardless of the amount of those

default judgments, the maximum amount MacArthur could recover from USF&G was $200,000 per person, based on the coverage limit of the underlying policies that USF&G issued to Western Asbestos. A2482 ¶ 4. And, in thereafter billing Reinsurers, USF&G absorbed the first $100,000 per claim. And so, for example, James Newborn's $16.3 million judgment was capped at $200,000, with only $100,000 ceded to Reinsurers. A2380 ¶ 5.

Reinsurers ignore USF&G's success in getting MacArthur to agree to cap each default judgment claim at $200,000 as part of the settlement. Instead, Reinsurers charge—wholly ignoring USF&G's good faith standing defense—that USF&G wrongfully refused to defend MacArthur and that, as a result, certain asbestos claimants obtained default judgments in excess of $100,000 for diseases valued by the parties at less than $100,000 (*i.e.*, the Treaty retention amount) in connection with present and future claims.[26] As such, Reinsurers argue that certain default judgment holders may have received a windfall, the cost of which USF&G improperly passed along to Reinsurers. The premise of Reinsurers' argument is fundamentally flawed.

USF&G reasonably denied any obligation to defend MacArthur in connection with asbestos-related personal injury lawsuits based on a standing defense which was sustained in the 1997 California appellate decision holding

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26 Reinsurers cite as an example one individual with asbestosis (valued at $50,000 for settlement purposes in connection with pending and future claims) who had obtained a default judgment on August 24, 2001 for $250,000. *Compare* A2384 ¶ 7(c) *with* A1551 (second claimant).

that MacArthur did not acquire Western Asbestos's insurance when it bought the assets of the Company. *See Gen. Accident*, 55 Cal. App. 4th at 1445. It was not until April 19, 2002, one-and-a-half months before the parties settled, that the trial court rejected USF&G's objection to MacArthur reviving Western Asbestos so it could effectively circumvent the 1997 standing ruling by achieving a retroactive transfer of insurance policies. A1709-11. On these facts, USF&G's assertion of the standing defense (in response to MacArthur's claim for coverage) was, as the Appellate Division held, manifestly reasonable and in good faith. A30-31. Reinsurers' second-guessing of USF&G's decision not to defend the underlying asbestos claims is precluded by follow the fortunes (which protects a cedent's good faith tactical decisions in the handling of claims).

It bears noting that, throughout the course of the underlying *MacArthur* Action, USF&G provided Reinsurers with comprehensive updates and Reinsurers praised the "excellent" job USF&G had done keeping them apprised. A982 ("Reinsurers were provided with an excellent summary of the claim"). *See also* A984-85; A994-1101. As the Appellate Division noted, Reinsurers "manifestly had the right, under the Treaty, to associate in the defense of the claim, but chose not to do so." A23 n.3; A799 ¶ 6.[27] AmRe was

[27] In the summer of 2000, AmRe discussed internally whether to retain Bates & Carey, the coverage litigation counsel which later sued USF&G on behalf of AmRe in this action, to associate in the defense of the *MacArthur* Action. A1102; A1103. USF&G advised AmRe that USF&G had no objection to AmRe invoking its right to associate

intimately familiar with the proceedings in the *MacArthur* Action and tracked them carefully. AmRe even commented in internal memoranda prepared in 2000 about MacArthur's attempt to "resurrect Western Asbestos back into existence" so it could "assign its policy rights over to" MacArthur. A1037. After sitting idly during the course of the *MacArthur* Action, Appellants cannot now question USF&G's handling of the case. *See* A799 ¶ 6; *Unigard*, 79 N.Y.2d at 583 (follow the fortunes "leaves reinsurers little room to dispute the reinsured's conduct of the case"); *Seven Provinces*, 9 F. Supp. 2d at 69-70.[28]

C. Reinsurers' Argument That USF&G Should Not Have Compromised Its Coverage Defense On Trigger Of Coverage Is Another Impermissible Attempt To Relitigate A Settlement Compromise

In the *MacArthur* action, the court granted USF&G's *unopposed* motion for partial nonsuit on plaintiffs' claim that the USF&G policies

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under the Treaty. A1043. AmRe ultimately chose not to associate in the defense of the lawsuit. A1044; A1105 at 199:15-18 ("[AmRe] had as much information as possible and could have associated in the case and helped us defend the case but they didn't want to do it"). AmRe's current assertion that it did not associate in USF&G's defense because AmRe understood that USF&G did not issue any insurance policies is demonstrably false. *See*, *e.g.*, A1024 (confirming that USF&G had advised AmRe in 1998 that there was secondary evidence that Western Asbestos was a USF&G insured).

[28] AmRe contends that the Appellate Division's recognition of Reinsurers' right to associate in the defense of the *MacArthur* Action was somehow "puzzling[]." AmRe Br. at 17. While Reinsurers cite to *Unigard* to support this contention, *Unigard* merely held that to assert a late notice defense, a reinsurer must show prejudice, which would not be presumed merely by the loss of the right to associate in the defense of the underlying case. *Unigard Sec. Ins. Co. v. N. Riv. Ins. Co.*, 79 N.Y. 2d 576, 584 (1992). *Unigard* does not permit a reinsurer—particularly one that expressly declined to associate in the defense of the underlying claims—to later second guess its cedent's litigation and claims handling decisions.

contained an “occurrence” endorsement (A566-69; A1489-90), and the parties stipulated as part of the settlement that the underlying policies were written on a “‘caused by accident,’ as opposed to an ‘occurrence,’ basis” (A 417 ¶ 10). However, an open issue in the litigation, which was not resolved by the court, was whether a continuous trigger applied to policies written on a “caused by accident” basis.

In the underlying coverage litigation, USF&G asserted—like Reinsurers do now—that the continuous trigger doctrine was inapplicable because the policies were written on a “caused by accident” (as opposed to “occurrence”) basis. A2387 ¶ 3; A2482 ¶ 3. The asbestos plaintiffs countered that a continuous trigger also applies to policies written on a “caused by accident” basis, and argued that there was California precedent directly on point. A2387-88 ¶ 3; A2482 ¶ 3. During the back-and-forth of negotiations, USF&G ultimately compromised on this issue—just as the other side compromised on other issues. A2388 ¶ 4; A2482 ¶ 3.

Reinsurers now irresponsibly speculate, without any basis in fact, that USF&G compromised its coverage defense—that the “caused by accident” policy language does not require a continuous trigger—to somehow mask USF&G’s secret payment of bad faith claims. Reinsurers’ argument, which lacks any evidentiary support, is simply an attempt to avoid the plain terms of the follow the fortunes clause. A799 ¶ 6 (USF&G may “defend, settle, or

compromise" any claim, with the result "binding upon the Reinsurers"). This Court should reject Reinsurers' improper attempt to "second-guess . . . [USF&G's] good faith decision to waive defenses to which it may be entitled." *Granite State*, 46 A.D.3d at 439.

In any event, USF&G's decision to compromise on the trigger issue certainly was reasonable. As the asbestos plaintiffs argued, *see* 2482 ¶ 3, *and as AmRe now concedes* (AmRe Br. at 28), prior to the settlement, a California Superior Court had applied the continuous trigger to asbestos bodily injury claims under coverage written both on a "caused by accident" and on a "caused by an occurrence" basis:

> While the parties to this action disagree as to the meaning of the policy language, they do agree that the trigger and scope of coverage under the pre-1966 CGL standard form policy language is the same as that of the 1966 CGL policy language. This identity of meaning is so despite the fact that some pre-1966 policies referred to injuries 'caused by accident' or 'accidentally sustained,' while the 1966 policy language refers to injuries caused by an 'occurrence.'

In re Asbestos Ins. Coverage Cases, No. 1072, Statement of Decision Concerning Phase III Issues, at 32, 42 (Cal. Super. Ct. Jan. 24, 1990) (applying a continuous trigger methodology), *aff'd in rel. part sub nom.*, *Armstrong*, 45 Cal. App. 4th at 43, 48. *See also Aerojet-Gen. Corp. v. Transp. Indem. Co.*, 17 Cal. 4th 38, 57 n.9 (1997) (discussing accident and occurrence language).[29]

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[29] The cases cited by Appellants—*Geddes & Smith, Inc. v. St. Paul Mercury Indemnity Co.*, 51 Cal. 2d 558 (1959), and *Lockheed Corp. v. Continental Insurance Co.*, 134

AmRe has raised similar challenges to cedents' compromises on trigger issues in other cases, which were roundly rejected for the precise reasons that the lower courts properly rejected Reinsurers' same challenge here. In *National Union v. American Re-Insurance Co.*, for example, AmRe disputed the appropriateness of a settlement predicated on a particular trigger theory. 441 F. Supp. 2d at 649, 653-54. The court held that the cedent's "unwillingness to litigate the trigger issue" with its policyholder was a legitimate business consideration for the cedent, and that, by reason of the follow the fortunes doctrine, AmRe could not challenge that decision. *Id.* at 654.

Factually, this case is nothing like *Allstate*, where the cedent applied one rule to the insured's claim at the direct level and another at the reinsurance level. *See* ECRA Br. at 56-57. Here, it is undisputed that USF&G settled on the basis that a "continuous trigger" applies to policies written on a "caused by accident" basis. A2387-88 ¶¶ 3-4; A2482 ¶ 3. Appellants also ignore the companion compromise among the parties that led to a settlement—*i.e.* while multiple policies were triggered, the insured could not stack limits and only *one* policy could be called upon to respond to a given claim. A2470 ¶ 8;

Cal. App. 4th 187 (6th Dist. 2005)—are property damage cases (not bodily injury cases) and do not involve asbestos. In addition, *Lockheed* was issued three years *after* USF&G's settlement and concerned "manuscript" policies that had been extensively negotiated rather than standard policy language. And, even if Appellants' cases were somehow relevant to the analysis, a cedent is entitled to waive a disputed coverage defense, free from challenge by its reinsurer.

A2384 ¶ 7(d). Unlike *Allstate*, USF&G mirrored the logic of the settlement in billing Reinsurers in all respects. A2347-48 ¶¶ 6, 11.

D. Picking Up On A Meritless Argument Now Abandoned By AmRe, Co-Reinsurer ECRA Seeks To Rewrite The Treaty To Tie Its Obligation To Indemnify Not To The Loss Incurred By USF&G In Adjusting And Settling Its Liabilities *To* MacArthur, But Instead To What A Given Tort Claimant Subsequently Received *From* The Parties With Whom USF&G Settled

Adopting a variation of an argument unsuccessfully made by AmRe in the trial court (A84-85) but abandoned on appeal, ECRA challenges Reinsurers' obligation to indemnify USF&G by improperly re-examining the facts of the *MacArthur* Action, picking out an isolated claimant and complaining that USF&G valued his $277,800 default judgment at $200,000 in negotiating the settlement, but that individual subsequently received only approximately $16,000 from the Judgment Escrow. ECRA Br. at 65. Beyond the fact that default judgment holders also received settlement consideration from the bankruptcy trust,[30] ECRA's reliance on amounts actually received by each asbestos claimant is wholly improper.

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[30] The amount any individual claimant received from the Judgment Escrow was in "partial satisfaction" of a claim. A158. Under the Settlement Agreement, "any remaining settlement amounts [were] to be paid from the 524(g) Trust." A383 § 3.1(a). There is no evidence in the record as to the final amounts that claimants received from the 524(g) Trust, as the Trust did not disclose any names of fund recipients out of concerns for their privacy. Thus, ECRA's reliance solely on amounts obtained from the Judgment Escrow could not be more misleading.

The Treaty, by its express terms, entitles USF&G to indemnification on the basis of what USF&G paid out to discharge its coverage obligations—not what was subsequently distributed to claimants from the Judgment Escrow or bankruptcy trust. The evidence is unrebutted that the parties valued default judgment claims exceeding $200,000 at $200,000 for settlement purposes and, for each such claim, USF&G paid $200,000 into the Judgment Escrow. A2482-83 ¶ 5. Once USF&G paid monies into the Judgment Escrow and bankruptcy trust, USF&G had no control over the subsequent distribution to individual asbestos claimants. A2483 ¶ 6; A2386 ¶ 13.

The critical contract term is "loss," which is the measure of what USF&G is obligated to pay its policyholder, and which forms the basis for Reinsurers' indemnity obligations to USF&G. *See* A795 ¶ 1 ("The Reinsurers hereby reinsure [USF&G] to the extent of . . . any loss . . . for which [USF&G] may become liable."). Under the plain language of the Treaty, a "loss" is suffered when USF&G makes payment to or on behalf of its policyholder. A799 ¶ 7 ("The Reinsurers' share of any loss hereunder shall be paid to [USF&G] upon proof of the payment thereof by [USF&G]."). Accordingly, the relevant inquiry is the amount USF&G paid in adjusting and settling its liabilities *to* MacArthur, not what a given tort claimant subsequently received *from* the insured tortfeasors with whom USF&G settled. A84-85, A96-98. *See*

also Am. Ins. Co. v. Am. Re-Ins. Co., 2006 WL 3412079, at *7 (N.D. Cal. Nov. 27, 2006) (rejecting AmRe's argument that a cedent did not suffer a compensable loss because monies it paid into trust had not yet "actually been distributed to pay for any claims").

III. ALL PARTIES TO THE SETTLEMENT HAVE SWORN THAT THE SETTLEMENT DID NOT ENCOMPASS ANY AMOUNTS ON ACCOUNT OF BAD FAITH AND REINSURERS HAVE NO EVIDENCE TO CONTRADICT THIS INDISPUTABLE FACT

The overwhelming and uncontradicted evidence is that USF&G's settlement payment was made *solely* in satisfaction of indemnity obligations created by the insurance policies sold to Western Asbestos. Nevertheless, Reinsurers baldly assert that the lower courts erred in holding that no portion of USF&G's settlement was attributable to MacArthur's bad faith claims. Reinsurers are wrong.

USF&G's $987 million settlement was approximately half the compensatory damage portion of MacArthur's settlement demand made a month-and-a half before the Settlement Agreement was executed (A2480), and all parties to the underlying settlement (*i.e.*, representatives of USF&G, the asbestos plaintiffs, and the MacArthur entities) have confirmed under oath that no portion of the settlement amount was in respect of alleged bad faith claims:

- David McClain, the asbestos plaintiffs' lead counsel during settlement negotiations, testified in the bankruptcy court that the asbestos plaintiffs negotiated "based on compensatory damages." A953 at 488:18-19. Mr. McClain also affirmed that

USF&G refused to pay any amount for MacArthur's bad faith claims. A2385 ¶ 9.

- Steven Snyder, MacArthur's settlement negotiator, testified that no portion of the settlement was allocable to bad faith. A1727 at 177:4-8.

- MacArthur's bankruptcy counsel confirmed that "[t]he USF&G claim was settled for substantially less than [MacArthur's] demand without regard to any bad faith claim against USF&G," and that he was "not aware that any such consideration was paid by USF&G for such claims." A2392 ¶ 15.

- USF&G's Timothy Yessman likewise affirmed under oath that no amounts were paid in settlement on account of USF&G's alleged bad faith exposure. A2471 ¶ 13.

The lower courts correctly held that, in light of this uniform testimony of all participants to the settlement negotiations, none of the arguments raised by Reinsurers is even remotely sufficient to permit them to avoid honoring their contractual obligations or even to raise a triable issue of fact on whether the settlement was "*arguably* within the scope of the insurance coverage that was reinsured." *Nat'l Union*, 441 F. Supp. 2d at 650-51(emphasis added). *See also Lloyd's*, 96 N.Y.2d at 596 (requiring indemnification for payments "reasonably within the terms of the original policy, even if technically not covered by it").[31]

[31] Reinsurers try to impeach the record (which conclusively demonstrates that no amount was paid in respect of bad faith) by citing an email from USF&G's settlement counsel. AmRe Br. at 32, 64-65 (citing A1429). This email says nothing about bad faith, only that the case (and law) got worse over time as often can happen. Further, when read in context it is clear that counsel was posturing during settlement negotiations to convince the other side to agree to what was a very favorable settlement for USF&G and, by extension, Reinsurers. *E.g.*, A2586 at 30:2-10 ("[USF&G's counsel is] puffing. Barry's, you know, engaging the other side to try to bring them down").

A. USF&G Paid Nothing On Account Of Bad Faith And It Is A Fallacy To Suggest That MacArthur's Mere Allegation Of Bad Faith Somehow Entails That USF&G Paid To Settle Such Claims

Appellants candidly admit that they hope to put USF&G on trial in this action (precisely what follow the fortunes is intended to protect against) to reallocate some portion of the settlement to MacArthur's bad faith claim—notwithstanding that the parties entered a compromise where USF&G paid only compensatory damages—because Reinsurers claim that USF&G acted in bad faith toward MacArthur.[32] In this regard, Appellants essentially parrot, in violation of follow the fortunes, the bad faith allegations made by MacArthur's counsel during a decade-long case. *See* AmRe Br. at 16-18; ECRA Br. at 7-11 (discussing USF&G's coverage positions, USF&G's "document destruction program" and a discovery dispute arising from archival materials donated to the Baltimore Museum of Industry).[33]

Those allegations were compromised by MacArthur as part of the settlement with no payment by USF&G, just as concessions were made by

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[32] Insureds almost always include bad faith claims against their insurers in coverage litigation in California and elsewhere. In fact, MacArthur asserted bad faith claims against all of its insurers—not just USF&G, but also ECRA pool members General Accident and Hartford. *See, e.g.*, A1623-52.

[33] The actual facts of what happened bear no resemblance to the "spin" in Appellants' briefs. For example, far from finding that "USF&G *intentionally* donated the documents to the museum to conceal them from [MacArthur]" (ECRA Br. at 9), the judge stated: "I think there was an obligation on the part of USF&G to exercise diligence in finding these records, because they were given to the [museum] . . . [and] that based upon that lack of diligence, it was at least technically willful. But I don't think what is being requested is appropriate sanctions." A1849.

USF&G as part of the settlement. Follow the fortunes precludes Reinsurers from resurrecting compromised disputes. Analytically, it is no less detrimental to a settlement to allow reinsurers to resurrect and relitigate the litigation position of the underlying policyholder to dispute a reinsurance claim, than it would be to allow a reinsurer to use against the cedent the defenses the cedent had raised against the policyholder's litigation position. *See CIGNA*, 52 F.3d at 1204; *Aetna Cas. and Sur. Co. v. Home Ins. Co.*, 882 F. Supp. 1328, 1346 (S.D.N.Y. 1995). *Both* variations of second-guessing would foster endless relitigation and discourage settlements for fear of risking loss of reinsurance.

Reinsurers claim nonetheless that, in the *MacArthur* Action, "there was 'substantial evidence' of USF&G's bad-faith conduct vis-à-vis its insured." AmRe Br. at 2, 16. But whether the evidence would have supported *MacArthur's* "claim for bad faith denial of coverage" (ECRA Br. at 9) is entirely distinct from whether USF&G paid any money for bad faith claims—a question which all parties to the underlying settlement resoundingly answered "no."[34] Not only is it bad faith for Reinsurers to put their own cedent "on trial,"

[34] While not relevant here because USF&G did not pay anything in settlement on account of bad faith, USF&G does not concede that the Treaty excludes extra-contractual liabilities. The Treaty provides reinsurance for "any loss *in connection with* each policy" issued by USF&G. A796 ¶ 2 (emphasis added). "[L]oss means "the *aggregate* loss . . . arising out of each accident." A797 ¶ 4 (emphasis added). This language is sufficiently broad to encompass bad faith liability. In addition, the Treaty explicitly states what it "does not cover," and bad faith liability is not excluded. A797 ¶ 3. And courts have held that a reinsurer may be liable for extra-contractual liability where, as here, (i) the treaty contains a follow the fortunes clause; (ii) the reinsurer was kept informed of developments in the underlying coverage action; and (iii) the reinsurer did not exercise its contractual right to associate in the

but Appellants' request for a mini-trial to determine what theoretically might have happened had the parties gone to trial on the issue of bad faith is not permitted under settled follow the fortunes case law. *See CIGNA*, 52 F.3d at 1205 ("[I]t is well settled that [follow the fortunes] applies generally to all outcomes of coverage disputes, whether in the form of settlements or judgments."); *Unigard*, 79 N.Y.2d at 583 (follow the fortunes "leaves reinsurers little room to dispute the reinsured's conduct of the case").[35]

Reinsurers make much of the fact that USF&G obtained the broadest possible release as part of the Settlement Agreement for "any and all claims," including claims for "bad faith or other extra-contractual liability." A389 ¶ 4.1. But the fact that USF&G obtained a broad release in exchange for agreeing to pay nearly $1 billion to settle the *MacArthur* Action—which any prudent defendant paying significant monies would seek in a settlement—does not mean that USF&G paid monies on account of bad faith liability.[36] To the

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defense of the underlying suit. *See Peerless Ins. Co. v. Inland Mut. Ins. Co.*, 251 F. 2d 696, 702-04 (4th Cir. 1958).

[35] The trial court's denial of USF&G's motion for summary judgment on MacArthur's bad faith claims is not tantamount to a finding that USF&G acted in bad faith vis-à-vis MacArthur. *Kerns v. CSE Ins. Grp.*, 106 Cal. App. 4th 368, 396 (1st Dist. 2003) ("denial of [a] motion for summary judgment establishe[s] nothing more than the existence of triable issues of material fact to be finally determined at trial").

[36] The adequacy of USF&G's reserves also is irrelevant to this reinsurance dispute, as is the fact that the SEC asked for clarification (as it often does) before approving USF&G's public disclosure about the Settlement. RA337-344; RA345-49. And it is the height of hypocrisy for Appellants to suggest that USF&G's "financial condition," ECRA Br. at 13-14, may have incentivized USF&G to inflate its reinsurance bill in 2002 when, during the exact same time period, (i) AmRe's German parent company had to inject over two billion dollars into its "ailing US subsidiary" to improve its

contrary, every party to the settlement negotiations testified that USF&G did not pay any consideration on account of bad faith.

In any event, as the Appellate Division correctly noted, bad-faith liability does not even arise in California where coverage is genuinely disputable. A31 (citing *Bosetti v. U.S. Life Ins. Co. in City of N.Y.*, 175 Cal. App. 4th 1208, 1237 (2d Dist. 2009)). Here, in the underlying coverage case, a genuine issue existed, at a minimum, with respect to whether MacArthur had standing to claim any rights under insurance policies issued to Western Asbestos, and thus whether USF&G owed any duty whatsoever to MacArthur.

ECRA claims that USF&G's bad faith was the result of its "other defenses," including USF&G's defense that the missing policies did not provide products coverage, and even if they did, there would be aggregate limits. However, as reflected in an internal AmRe memo, AmRe *agreed with USF&G* that "[b]ased upon [AmRe's] review of the available policy information, [AmRe] d[id] not see evidence that USF&G provided product liability coverage to Western Asbestos . . . [and] if they did, . . . the product limits would aggregate." A1039. Moreover, in its settlement demand a *month-and-a-half* before the parties settled, MacArthur provided USF&G with a *50% discount* for "coverage risks that there is no products coverage or there is an aggregate

balance sheet (8/1/02 REACTIONS 7, 2002 WLNR 9182311); and (ii) ECRA was in "run off" (*i.e.*, no longer looking for any new insurance business, and instead just winding down old insurance business) (A1127 ¶ 5).

limit." A2480. Reinsurers cannot accuse USF&G of bad faith for raising good faith coverage defenses whose merits MacArthur itself took into account when discounting its claim by hundreds of millions of dollars.

B. Reinsurers' Speculation That USF&G Settled Because It Was Concerned About Bad Faith Liability Is Not A Valid Basis For Refusing To Pay Their Share Of The Underlying Settlement

Reinsurers speculate that USF&G may have settled to avoid a verdict on MacArthur's bad faith claim. AmRe Br. at 21; ECRA Br. at 11-12. However, "[m]ere conclusory assertions, devoid of evidentiary facts, are insufficient [to defeat a well-supported summary judgment motion], as is reliance upon surmise, conjecture, or speculation." *Grullon v. City of New York*, 297 A.D.2d 261, 263-64 (1st Dep't 2002).

The facts in the record flatly belie any notion that USF&G settled for anything other than compensatory damages. The unrebutted record here is that USF&G settled for $987 million in compensatory damages because MacArthur was seeking approximately $2 billion on account of asbestos-related claims. A2383-84 ¶¶ 5-6; A2469-71 ¶¶ 5-6, 12; A1727-28 at 177:17-178:7. In addition, bad faith liability was not even the subject of Phase I of the trial, in the middle of which the parties settled. In fact, the issue of bad faith was not scheduled to be tried until Phase III of the trial before a separate jury. A881-83. And, as demonstrated above, there is ample evidence in the record, including express acknowledgement by *both* Reinsurers and MacArthur, supporting the

legitimacy of USF&G's coverage defenses—all of which is consistent with USF&G's steadfast refusal to pay a single penny in settlement for bad faith.

Reinsurers' reliance on *American Insurance Company v. North American Company*, 697 F.2d 79 (2d Cir. 1982), is misplaced. In that case, the Second Circuit correctly stated that where "*there is genuine ambiguity over what a settlement covers, a 'follow the fortunes' clause may oblige a reinsurer to contribute to a settlement even though it might encompass excluded items*." *Id.* at 81. The Second Circuit affirmed the trial court's judgment in favor of the reinsurer in that case because a Minnesota state court jury had awarded only $146,970 of compensatory damages and $750,000 of punitive damages against the insurer, and thereafter the insurer settled the Minnesota case for $500,000. Accordingly, it was "clear" in that case that the settlement was "primarily designed to compensate [the policyholder] for a punitive damage award that [wa]s excluded from the reinsurance policy." *Id.* By contrast, no verdict on bad faith was issued against USF&G, and USF&G settled for approximately half of the indemnity portion of MacArthur's settlement demand.[37]

[37] *National Union Fire Insurance Co. v. Clearwater Insurance Co.*, 2007 WL 2106098 (S.D.N.Y. July 21, 2007), cited by Reinsurers, also is inapposite. In that case, because the settlement occurred during the consequential damages phase of the trial, fact issues existed as to whether the settlement involved payment of consequential damages, which apparently were not covered under the reinsurance contract at issue. Here, the underlying case settled in the first phase of the case addressing "policy language" long before bad faith claims would be tried. A881-83. In addition, the settlement negotiators for USF&G, the asbestos plaintiffs and MacArthur each have given unrebutted testimony that USF&G paid nothing for bad faith.

It would defeat the entire purpose of the follow the fortunes doctrine, and have a chilling effect on settlements, to allow Reinsurers to resurrect and prosecute against its cedent a bad faith claim that a cedent's policyholder relinquished as part of a series of compromises that resulted in a settlement. *See CIGNA*, 52 F.3d at 1206 (reinsurers cannot "revisit coverage issues resolved between the insurer and its insured"); *Seven Provinces*, 9 F. Supp. 2d at 66 ("If the ceding company knew that its settlement decisions could be challenged by every reinsurer, there would be little incentive to settle with the insured.").

C. Appellants Distort The Bankruptcy Court Opinion Which Plainly States That It Was Not Making A Finding That USF&G Paid Settlement Monies On Account Of Bad Faith And Was Not Adjudicating The Merits Of The Bad Faith Claims

Finally, Appellants claim (incorrectly) that the bankruptcy court opinion confirming the reorganization of the MacArthur entities (collectively, "Debtors") found that USF&G paid monies in settlement on account of bad faith. As the four judge Appellate Division majority correctly ruled, "the parties to the bankruptcy proceeding never litigated whether USF&G paid monies to MacArthur on account of bad faith" (A29), and the Bankruptcy Court specifically "disavowed" that it was making any finding on that issue (A30). Indeed, the bankruptcy court's decision expressly states that the Court was not deciding the merits of any potential bad faith claim. A208 n.19 ("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.") (emphasis added) & A247 n.40. In any event, the portion of the bankruptcy court opinion on which Reinsurers rely simply does not say what Reinsurers claim and it has no evidentiary value. The true facts are these:

Debtors asked the bankruptcy court to, among other things, approve their reorganization plan, including an injunction against future claims under 11 U.S.C. § 524(g). A2389-90 ¶ 3. At least four insurers, including ECRA member Hartford, objected to Debtors' reorganization plan ("Objecting Insurers"). A2390 ¶ 4. Objecting Insurers argued that Debtors' contributions to the trust were insufficient to entitle them to an injunction against future claims. To rebut that contention, Debtors presented evidence that they were contributing the value of their potential inchoate bad faith claims against Objecting Insurers—*not USF&G*—to the trust. A2390 ¶ 5; *see also* A2595 at 3754:9-14. Critically, no one ever requested that the bankruptcy court determine whether Debtors had any meritorious bad faith claim against USF&G at all—let alone whether USF&G paid any money in satisfaction of bad faith. A2390 ¶ 6. Indeed, counsel for Objecting Insurers conceded at the time that "[t]he evidence here is that none of the USF&G settlement has been allocated to a bad faith claim." A2596 at 3825:22-23.

Debtors thereafter settled with Hartford, A2390 ¶ 7, and the bankruptcy court subsequently issued a decision approving Debtors' reorganization plan, including their settlements with USF&G and Hartford. The final bankruptcy court decision explicitly states:

- "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." A208 n.19 (emphasis added).
- "[B]y finding that the Debtors' bad faith claims were of sufficient value to justify the issuance of the injunctions, the Court is *not actually deciding the merits* or specific value of the Debtors' *potential* bad faith claims against any insurer." A247 n.40 (emphasis added).

In sum, the bankruptcy court merely considered Debtors' potential bad faith claims against Hartford, the remaining Objecting Insurers, and USF&G in the aggregate, and concluded (expressly without addressing merits or specific value) that Debtors met their statutory requirements for relief under 11 U.S.C. § 524(g).[38]

As Debtors' bankruptcy counsel has confirmed, the parties never litigated whether USF&G paid monies in settlement on account of bad faith, and the bankruptcy court made no finding on that issue:

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38 *See* A246 ("[T]he Debtors' business loss claims include their potential bad faith claims against USF&G and Hartford as well as the remaining Objecting Insurers."); A247 ("The Court finds the contribution of the Debtors' bad faith claims sufficient to justify the issuance of an 11 U.S.C. []§ 524(g) injunction.").

> The USF&G claim was settled for substantially less than the Debtors' demand without regard to any bad faith claim against USF&G. The parties never litigated before the bankruptcy court the issue of whether USF&G paid any consideration in settlement on account of the Debtors' bad faith claims in the underlying coverage action, and I am not aware that any such consideration was paid by USF&G for such claims. That issue was never briefed, tried or argued before the bankruptcy court.

A2392 ¶ 15. Reinsurers were not parties to the bankruptcy court proceeding, and their refusal to accept the testimony of Debtors' bankruptcy counsel concerning what transpired and the import of the bankruptcy court decision further demonstrates the bad faith on the part of Reinsurers and the lengths they will go to avoid honoring their obligations.

Even the Appellate Division dissent recognized that Appellants were "mistaken" when they urged that the bankruptcy court decision had collateral estoppel effect on USF&G with respect to whether it paid monies in settlement on account of bad faith. A40.[39] In the absence of preclusive effect, the bankruptcy court's findings are inadmissible in this action. *See Liberty Mut. Ins. Co. v. Rotches Pork Packers, Inc.*, 969 F.2d 1384, 1388 (2d Cir. 1992) (finding error where the "district court relied upon the Bankruptcy Orders

[39] Collateral estoppel is applicable only to issues that were "actually litigated, squarely addressed, and specifically decided." *Ross v. Med. Liab. Mut. Ins. Co.*, 75 N.Y.2d 825, 825 (1990). Here, it is unrebutted that the parties never litigated whether USF&G paid monies in settlement on account of bad faith, as MacArthur's bankruptcy counsel acknowledged. A2392 ¶ 15; *see also* A2394 (letter from USF&G's bankruptcy counsel to Bankruptcy Court emphasizing that "the bad faith claims were not actually litigated"—a position ultimately adopted by the court in adding footnotes to its earlier tentative decision). *See* A208 n.19; A247 n.40.

precisely to establish facts asserted therein"); *U.S. v. Jones*, 29 F.3d 1549, 1553 (11th Cir. 1994) (a court may take judicial notice of another court's order for the purpose of recognizing the judicial act but not to recognize that court's findings of fact as true).

IV. REINSURERS' COMPLAINTS ABOUT USF&G'S ALLOCATION OF THE LOSSES TO THE 1959 TREATY YEAR IS AN IMPROPER ATTEMPT TO DISSECT THE SETTLEMENT ITSELF AND IS WITHOUT MERIT

A. The Lower Courts Correctly Held That Reinsurers Are Bound To Follow USF&G's Reasonable And Good Faith Allocation Since The Allocation To the 1959 Treaty Year Is Consistent With How The Underlying Settlement Was Negotiated

It is indisputable that USF&G allocated all of its payments made pursuant to the Settlement Agreement to the underlying Western Asbestos policy that incepted in 1959 (A2471-72 ¶ 14) and that, when preparing its reinsurance cession, USF&G allocated USF&G's losses to the corresponding 1959 Treaty year consistent with its usual practice of following the rationale of the direct settlement (A2348 ¶ 11). As the trial court and Appellate Division correctly held, Reinsurers are barred as a matter of law from second-guessing USF&G's decisions concerning allocation of the loss. A28; A86-88. *See supra* Pt. I.B.2. The dissent in the Appellate Division did not question this holding.

In complaining about USF&G's decision to allocate the losses to the 1959 Treaty year, Reinsurers effectively challenge the manner in which

USF&G settled the *MacArthur* Action. *See supra* Pt. II. But this is precisely the kind of "intrusive factual inquiry" that follow the fortunes prevents:

> [W]e decline to authorize an inquiry into the propriety of a cedent's method of allocating a settlement if the settlement itself was in good faith, reasonable, and within the terms of the policies . . . . [W]ere we to undertake such an analysis, we would be engaging in precisely the kind of 'intrusive factual inquiry' that the follow-the-fortunes doctrine is meant to avoid. Judicial review of either the settlement decision or the allocation decision 'has an equal likelihood of undermining settlement and fostering litigation.'

Gerling, 419 F.3d at 189; *see also Allstate*, 43 A.D.3d at 121 ("the cases unequivocally hold that the [follow the fortunes] doctrine extends to a postsettlement allocation"); *Nat'l Union*, 441 F. Supp. 2d at 653 ("An inquiry into the reasonableness of National Union's post-settlement allocation is . . . inappropriate in light of [*Gerling*].").

In addition, contrary to Reinsurers' unsupported contention that USF&G "gerrymandered its reinsurance allocation by allocating the entire settlement to a single policy year" (ECRA Br. 57), the record is clear that USF&G reasonably allocated the loss to the Western Asbestos policy incepting in 1959 because:

- The parties to the settlement negotiated that one—and only one—of the thirteen consecutive policies that USF&G allegedly issued to Western Asbestos could be called upon to respond to each underlying asbestos claim, effectively conceding that a policyholder could not *stack* successive policy limits;

- The last policy year (*i.e.*, the policy incepting July 1, 1959) had the highest available limit ($200,000), which was the limit used in negotiating the amount each underlying claimant could potentially recover; and

- Only that last policy year (*i.e.*, the policy incepting in 1959) would encompass all claims for anyone exposed to asbestos during the settled period of 1948 to 1960.

See A2471-72 ¶ 14; *see also* A2384 ¶ 7(d); A950-951 at 157:19-159:6.[40]

As the trial court correctly recognized (A87-88), courts applying New York law routinely reject attempts by reinsurers, as Appellants do here, to suggest alternative allocation methodologies:

> 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.

N. River Ins. Co. v. ACE Am. Reins. Co., 2002 WL 506682, at *3; *see also Seven Provinces*, 9 F. Supp. 2d at 68 ("A ceding insurer could, in good faith, select any one of sixteen options [for allocation], only to have its various reinsurers each propose an alternative formula. If the 'follow the settlements'

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[40] ECRA (but not AmRe) highlights the fact that MacArthur never made an "all sums" election to the 1959 policy. ECRA Br. 58. But MacArthur never had to make an election because the parties settled. In addition, an election by a policyholder is not required in order for a reinsurer to be bound by reasonable allocation decisions made by its cedent, and indeed, Reinsurers would undoubtedly challenge any such election charging collusion as an excuse to avoid follow the fortunes. There can be no dispute here that the parties applied a *single* $200,000 per person limit to each asbestos claim.

principle did not apply to the allocation of those settlements, litigation would surely proliferate.").

Finally, contrary to Reinsurers' refrain that USF&G is trying to maximize its reinsurance, it did not matter financially whether USF&G assigned all claims to the 1959 Treaty year or assigned individual claims to different treaty years. USF&G could have assigned each of the individual claims (valued at $200,000)[41] to any of the underlying policies incepting between 1953 and 1959 since those policies had per person limits of $200,000 and were the only policies with per person limits high enough to accommodate each settled loss. *See* A416-17 ¶ 7.[42] If USF&G had assigned the $200,000 claims equally among the policies incepting between 1953 and 1959 and then allocated those payments among the seven years for reinsurance purposes, USF&G's reinsurance reimbursement would have been exactly the same as allocating the claims only to the 1959 year because the reinsurance retention during this entire multi-year time period was $100,000 *per claim*. A2275.[43]

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[41] Reinsurers can have no complaint as to how USF&G allocated claims that were valued at less than $100,000 (*i.e.*, asbestosis, pleural and other cancer claims) since USF&G absorbed the entire loss for those claims (*i.e.*, USF&G did not bill Reinsurers) because they fell entirely within the $100,000 Treaty retention.

[42] USF&G could not have allocated claims valued at $200,000 to the underlying policies incepting between 1948 and 1952 because the per person limits in those policies were $100,000 or less. A416-17 ¶ 7.

[43] AmRe and ECRA jointly provided USF&G with reinsurance coverage on a 50-50 basis during the treaty years incepting 1953 to 1959. A2275.

Far from attempting "through allocation [to] foist on to its reinsurers" (AmRe Br. at 6) uncovered losses, USF&G—playing by the *same set of rules* it applied at the direct insurance level—presented a reinsurance bill to Appellants for roughly 40% of USF&G's total liability, which was entirely consistent with the good faith claims handling decisions and compromises USF&G obtained and made to obtain an extremely favorable settlement.

B. Reinsurers' "Pay Nothing" Allocation Violates Both The Follow The Fortunes Doctrine And The Terms Of The Treaty

Appellants unabashedly contend that USF&G should have spread the payment associated with each individual asbestos claimant over multiple policy years and then applied more than one reinsurance retention to an individual claimant, wiping out USF&G's reinsurance coverage. ECRA Br. at 57. Appellants' argument violates the follow the fortunes doctrine, the Treaty language and public policy.

First, Reinsurers ignore the uncontroverted fact that USF&G successfully negotiated the settlement on the basis that only *one* policy could be called upon to respond to an individual asbestos claim. At bottom, it is Appellants who want to apply different rules to the reinsurance billing from the way USF&G settled the asbestos claims so that Appellants do not have to honor their reinsurance obligations and can pay nothing. Appellants' reverse gerrymandering, designed to vitiate USF&G's reinsurance protection, is blatant bad faith. This is precisely what the follow the fortunes doctrine was designed

to prevent. *Lloyd's*, 96 N.Y.2d at 596 (follow the fortunes "streamlines the reimbursement process and reduces litigation by preventing a reinsurer from continually challenging the propriety of a reinsured's settlement decision"). Moreover, a cedent is "not required to choose the allocation that *minimizes* its reinsurance recovery . . . ." *Gerling*, 419 F.3d at 193.

Second, Reinsurers' argument that multiple retentions should have been applied to a single claim spread over multiple years is flatly contradicted by the terms of the Treaty. The Treaty provides for a $100,000 retention per "loss," which the Treaty defines as "the aggregate loss . . . arising out of each accident . . . *regardless of the number of policies under which such loss is payable* . . . ." A797 ¶ 4 (emphasis added). As such, no single claim for bodily injury can be subject to more than one reinsurance retention.[44]

Third, Reinsurers wrongly claim that excess of loss is some special kind of coverage to which follow the fortunes does not apply. However, courts have routinely applied the follow the fortunes doctrine—in both the settlement and allocation context—when excess of loss insurance is involved. *See Lloyd's*, 96 N.Y.2d at 589-90 (acknowledging applicability of follow the fortunes to the excess of loss treaties at issue); *N. River*, 361 F.3d at 140 (rejecting reinsurers' argument that follow the fortunes should not apply because the ceding insurers

[44] Significantly, the parties amended the Treaty in 1962 to make *property damage* extending over a period of more than twelve months more than one loss and thus subject to more than one retention. A820.

"interests in allocating the loss to it are in conflict with those of [the reinsurer] and thus a fundamental premise of the follow-the-settlements doctrine, mutuality of interest, is missing"); *Gerling*, 419 F.3d at 188 (same). Indeed, at least one court has explicitly rejected the notion that follow the fortunes does not apply "in the context of excess of loss reinsurance as opposed to proportional reinsurance," failing to see "why the distinction should be important." *Home Ins.*, 882 F. Supp. at 1350. But more fundamentally, the excess of loss Treaty at issue here contains an *express* follow the fortunes clause.[45]

Finally, it is black letter law that a contract should not be read in a manner that would render the promise to provide coverage illusory or would amount to a forfeiture of the insurance policy at issue. *Simplexdiam, Inc. v. Brockbank*, 283 A.D.2d 34, 38 (1st Dep't 2001). Accordingly, courts applying New York law generally have recognized that the number of deductibles tracks the numbers of limits/years of coverage available to the policyholder. Thus,

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[45] AmRe also argues that while USF&G could have purchased "quota share" reinsurance, USF&G instead purchased what AmRe characterizes as a more "limited form" of "excess of loss" protection. But it is undisputed that USF&G applied the Treaty's $100,000 retention to each loss, which is why USF&G ceded only $400 million of the $987 million settlement to its reinsurers. While Reinsurers may have charged a higher premium if they could have anticipated such a large exposure when the Treaty was issued in the 1950s, USF&G likewise had to fund a centi-million dollar settlement under policies written with low limits (for low premium) when current tort and coverage principles were unknowable. It is precisely this type of underwriting (mis)fortune that Reinsurers agreed to follow. Robert F. Salm, *Reinsurance Contract Wording*, *in* Reinsurance at 116 (Robert W. Strain, 4th ed. 1987).

courts have held that unless the policyholder collects multiple sets of limits for an individual claim (here, they did not), an insurer cannot stack deductibles to the detriment of an insured in cases of continuous harm arising from asbestos injury occurring over multiple policy periods:

> Under American Club's pro rata allocation approach, one deductible would apply *per claim* as well as *per triggered policy*, whereas under the Claimants' approach, all losses from any single claim would be recovered under a single policy and therefore a single deductible would apply to each claim. . . . [W]e decline to read the policies in a way that would have the (probably unintended) effect of multiplying the deductibles applicable to each claim.

In re Prudential Lines Inc., 158 F.3d 65, 86 (2d Cir. 1998).[46]

C. Reinsurers' Reliance On The "Other Insurance" Clause In The Underlying Policies To Challenge The Assignment Of Losses To A Single Policy Is Yet Another Impermissible Attempt To Pick Apart USF&G's Settlement Methodology

As part of the back and forth of settlement discussions that enabled the parties to resolve the underlying action, USF&G assigned its rights against other insurers to the bankruptcy trust.[47] Willfully ignoring this fact, Reinsurers

[46] This result is consistent with the California Court of Appeal's decision in *Cal. Pac. Homes, Inc. v. Scottsdale Ins. Co.*, 70 Cal. App. 4th 1187, 1194 (1st Dist. 1999).

[47] USF&G's assignment of its contribution rights against other insurers to the bankruptcy trust (A396 ¶ 9.1) helped secure a §524(g) injunction precluding any claims against USF&G by other insurers. A392-94 ¶ 8.2. This benefited USF&G (and derivatively Appellants) because other insurers were seeking contribution from USF&G and objected to the settlement in the bankruptcy court on this basis. A1880; A1926. USF&G would not have obtained in the bankruptcy an injunction against those contribution claims if USF&G had sought to reserve the right to seek contribution from other insurers.

yet again attempt to impermissibly challenge a compromise that was part and parcel of the settlement. Under the Treaty and applicable law, Reinsurers simply cannot do so. *See Unigard*, 79 N.Y.2d at 583.

Reinsurers claim that, by virtue of the "other insurance" clause in the underlying policies and equitable contribution principles, no single policy may be held to bear all the loss when multiple policies are triggered. AmRe Br. at 30; ECRA Br. at 61-62. Even assuming *arguendo* this were true, USF&G is permitted to compromise, even "capitulat[e]" in its handling of the underlying litigation. *Allstate*, 43 A.D.3d at 121. In any event, however, as the lower courts correctly held (A32, A89), the allocation principles to which Reinsurers refer relate to apportionment among *different insurers*—not apportionment among policies issued by the same insurer. *Dart Indus., Inc. v. Commercial Union Ins. Co.*, 28 Cal. 4th 1059, 1079 n.6 (2002) ("'[o]ther insurance' clauses become relevant *only where* several insurers insure the same risk at the same level of coverage") (emphasis added).[48]

Reinsurers' argument is completely irrelevant because, here, one insurer provided all the coverage at issue. Obviously, it would be nonsensical to force USF&G to seek contribution against itself. Reinsurers' "other

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[48] *See also California v. Cont'l Ins. Co.*, 88 Cal. Rptr. 3d at 303 (liability must be "allocated *among the insurers* in accordance with *their contribution rights*") (emphasis added); *Travelers Cas. & Sur. Co. v. Century Sur. Co.*, 118 Cal. App. 4th 1156, 1160 (4th Dist. 2004) (same); *Fireman's Fund Ins. Co. v. Maryland Cas. Co.*, 65 Cal. App. 4th 1279, 1293 (1st Dist. 1998) (same); *Aerojet*, 17 Cal. 4th at 57 n.10 (same).

insurance" argument is a complete red herring since the real issue is Reinsurers' improper bid to stack reinsurance retentions in order to advance their interests over those of their cedent. *See Prudential Lines*, 158 F.3d at 86 ("we will not infer from this [other insurance] clause an intent to allocate liability among American Club's own policies when the only consequence of such allocation would be to multiply the deductibles applicable to each claim").[49]

V. APPELLANTS CANNOT AVOID THEIR INDEMNIFICATION OBLIGATIONS SIMPLY BECAUSE USF&G, LIKE REINSURERS, SOUGHT TO DETERMINE ITS POTENTIAL NET EXPOSURE PRIOR TO ENTERING INTO THE SETTLEMENT

Seizing upon language from a Third Circuit case (and without advising that the appellate court there affirmed the trial court's Phase I ruling *in favor of the cedent* based on the follow the fortunes doctrine and rejected each one of the reinsurer's bad faith arguments), Reinsurers speculate that USF&G improperly considered reinsurance implications when settling the *MacArthur* Action. *See, e.g.*, AmRe Br. at 33-34 (quoting *Ins. Co. of N. Am.*, 609 F.3d

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[49] ECRA, but not AmRe, argues that USF&G violated the doctrine of "horizontal exhaustion" by allocating the losses to a single policy year. ECRA Br. 59. "Horizontal exhaustion" is a doctrine that requires that an insured must exhaust all its primary insurance before it can call upon its excess insurance, an issue not relevant here. *N. Am. Capacity Ins. Co. v. Claremont Liab. Ins. Co.*, 177 Cal. App. 4th 272, 293 (2nd Dist. 2009). To the extent that ECRA is misusing "horizontal exhaustion" to refer to California cases that allocate a continuous loss among different insurers when more than one insurer is liable, those cases are inapplicable when, as here, a single insurer is involved as discussed above. *See Montrose Chem. Corp. v. Admiral Ins. Co.*, 10 Cal. 4th 645, 681 n. 19 (Cal. 1995) (addressing allocation "once several insurers have been found liable to indemnify the insured"); *Armstrong*, 45 Cal. App. 4th at 51 (same); *Stonewall Ins. Co. v. City of Palos Verdes Estates*, 46 Cal. App. 4th 1810, 1861 (2nd Dist. 1996) (same).

143). However, as an initial matter, Reinsurers have not demonstrated that a cedent forfeits reinsurance protection simply by considering reinsurance at the time that it settles. *See Gerling*, 419 F.3d at 191 (a reinsurer can avoid the dictates of follow the fortunes only if it can make an "*extraordinary* showing of a disingenuous or dishonest failure" on the part of the cedent); *see also Ins. Co. of N.Y. v. Associated Mfrs. Mut. Fire Ins. Corp.*, 70 A.D. 69, 71 (1st Dep't 1902) ("the [reinsurer] could not question the validity of the [ceding company's] act, unless it alleged and proved that the [cedent] had acted fraudulently or collusively to its injury"); *Ins. Co. of N. Am.*, 609 F.3d at 158 (holding that there is not "a positive duty on the part of the insurer to minimize its reinsurance recovery.").

In any event, Appellants do not (and cannot) cite any evidence that establishes that reinsurance implications impacted in any way USF&G's settlement decisions. Instead, Reinsurers rely on two charts that USF&G prepared prior to the settlement in which USF&G simply added up, as a mathematical exercise, the individual claims with values in excess of the $100,000 retention in the Treaty. AmRe Br. at 34 (discussing A1525-28, A1531). In the very case that Reinsurers rely upon, the Third Circuit held that it was entirely proper for a cedent to seek to determine its potential net exposure prior to entering into a settlement agreement. *Ins. Co. of N. Am.*, 609 F.3d at 163. Indeed, Reinsurers also made reinsurance calculations based on a

$100,000 retention prior to the settlement—which of course contradicts Reinsurers' argument (*see infra* Pt. VI) that the parties raised the Treaty retention from $100,000 to $3,000,000. A939-40. USF&G's merely taking cognizance of the reinsurance retention does not entail an improper engineering of the underlying settlement such that Appellants should be relieved of their contractual obligation to indemnify USF&G for hundreds of millions of dollars. *Cf. Gerling*, 419 F.3d at 193 (a cedent is "not required to choose the allocation that *minimizes* its reinsurance recovery . . .").

VI. APPELLANTS' ARGUMENT THAT THE PARTIES ORALLY AGREED TO INCREASE THE RETENTION AMOUNT IN THE TREATY—MADE FOR THE FIRST TIME SIX YEARS INTO THIS LITIGATION—IS BASELESS AND CONTRARY TO APPELLANTS' OWN PLEADING

After over half a decade of litigation, ECRA raised for the first time an argument that the parties had orally agreed to increase retroactively the per-loss retention in the Treaty from $100,000 to $3,000,000—which would eliminate *any* coverage for the reinsurance claims at issue. However, it is undisputed that the parties undertook to effectuate any retention increase by endorsement. Here, there are *no* endorsements increasing the retention amount of the Treaty at issue. The only endorsements reflecting a retention increase were in relation to post-1962 treaties.

There is no Appellate Division dissent from the Panel ruling rejecting Reinsurers' argument that the parties retroactively increased the

retentions of pre-1962 treaties. First, Reinsurers' internal documents from the 1980s make very clear that Reinsurers considered seeking a retention increase back to pre-1962 treaties but opted against it because the earlier treaties were profitable. A1946-47. Second, during the next ten plus years, the parties drafted, exchanged and signed endorsement increasing the retentions of only post-1962 treaties, leaving the retention in the pre-1962 Treaty here at $100,000. A2552-58; A1948-66; A2563-77; A1937-38; A2331-45; A1928-32; A1939-45. Third, in the mid-1990s, USF&G billed Reinsurers in connection with two multi-million dollar claims—Abbott Labs and Delaware Insulation—under the very same Treaty based on a $100,000 retention, which Reinsurers paid on that basis. A659-71; A672-82; *see also* A2053 at 245:11-17; A2056-57 at 395:12-396:24; A2062-64 at 51:13-18; 117:23-118:2. Fourth, prior to the underlying settlement in June 2002, Appellants listed the retention of pre-1962 treaties as $100,000 in their internal documents relating to the present MacArthur claim. A825; A826; A936-41; A982-83; A2079-81. Finally, in connection with its 2006 summary judgment motion, AmRe itself affirmed in its statement of *undisputed material fact* that under the Treaty, "USF&G is to absorb the first $100,000 in loss from each accident." A848 ¶ 57. Having repeatedly asserted as fact in the trial court that the Treaty retention was $100,000, AmRe is estopped from arguing otherwise now on appeal. *See* 57 N.Y. Jur. 2d Estoppel § 58 (2012).

Appellants now contend that the lower courts erroneously resolved factual disputes on the retention issue. Far from doing so, the trial court granted summary judgment for USF&G on the retention issue because: (i) "the parties only drafted and signed policy endorsements increasing the retention of post-1962 treaties"; and (ii) "the court must afford the unambiguous provisions of the policy their plain and ordinary meaning." A89, A93. The trial court reviewed the record simply to determine whether any reasonable fact finder could find clear and convincing evidence of mutual mistake or fraud sufficient to sustain a claim of reformation. A93. The trial court held that Reinsurers failed to raise a triable issue of fact as to either mutual mistake or fraud. *Id*. The Appellate Division *unanimously* affirmed in all respects. A23-26.

A. Extrinsic Evidence Cannot Be Used To Alter The Unambiguous Terms Of The Contract

AmRe attached a "true and correct" copy of the Treaty to its Complaint when it initiated this case in 2002. A788 ¶ 27; A794-822. That Treaty clearly and unambiguously states that the retention is $100,000. A795-96 ¶¶ 1-2, A798 ¶ 5. If a contract is clear and unambiguous, as is the case here, courts cannot consider extrinsic evidence submitted by a party in opposition to a summary judgment motion to vary the terms of the contract. 3 Robert L. Haig, *New York Practice Series – Commercial Litigation in New York State Courts* § 30:9 (3d ed. 2010). "Evidence outside the four corners of the document as to what was really intended but unstated or misstated is

generally inadmissible to add to or vary the writing." *W.W.W. Assocs., Inc. v. Giancontieri*, 77 N.Y.2d 157, 162 (1990); *see also Stevens & Thompson Paper Co. v. Niagara Mohawk Power Corp.*, 49 A.D.3d 1011, 1014 (3d Dep't 2008) ("extrinsic evidence of the parties' intent . . . is not admissible to imply a term, create an ambiguity or vary the terms of the . . . agreement"); *Stroll v. Epstein*, 818 F. Supp. 640, 646 (S.D.N.Y. 1993) ("Where a contract is unambiguous on its face, evidence of conduct occurring subsequent to the execution of the contract may not be introduced to create ambiguity in the contract.").

In an attempt to circumvent the parol evidence rule, Appellants argued below that parol evidence is admissible to establish a subsequent oral agreement, even though it may alter or abrogate a prior written agreement. However, the parties here documented their subsequent agreement on the retention issue *by endorsement* to "create[] the understanding between the parties for going forward." A2560-62 at 305:3-307:25; *see also* A2304 ¶ 9; A2467 ¶ 4. This process took over ten years to complete, and it is undisputed that the only endorsements that exist reflecting a retention increase were for *post-1962* treaties. A2552-58; A1948-66; A2563-77; A1937-38; A2331-45; A1928-32; A1939-45. *See also* A2304 ¶ 9; A2467 ¶ 4; A2579-83 at 251:11-17; 259:25-262:17.

B. The Record Indisputably Shows That The Parties Sought To Effectuate All Retention Increases By Endorsement And Such Endorsements Relate Solely To *Post-1962* Treaties Not At Issue Here

Reinsurers do not, because they cannot, proffer any evidence contradicting the indisputable fact that the parties effected the retroactive retention increase by endorsement. USF&G's Joseph Conwell stated in his affidavit that "USF&G and its reinsurers sought to memorialize their agreement concerning the retention increase by endorsement," and that he was "not aware of any endorsements that were ever prepared, negotiated, exchanged or signed increasing the retentions of pre-1962 treaties." A2304 ¶ 9.

James Steen of Guy Carpenter, the parties' reinsurance intermediary, similarly stated in his affidavit that "Guy Carpenter, with [Steen's] involvement, prepared and circulated endorsements . . . to memorialize the parties' agreement with respect to the increase in retention to $3 million," and that "[w]hile endorsements were signed retroactively increasing the retention for post-1962 reinsurance treaties, none of which [he] [was] aware was prepared or signed to increase the retention with respect to pre-1962 reinsurance treaties." A2467 ¶ 4.[50]

[50] Mr. Steen signed the affidavit for USF&G to clarify an earlier affidavit he had signed for Appellants. Other witnesses that Appellants convinced to sign affidavits with respect to the retention issue for use by Appellants in this case also subsequently signed counter-affidavits after USF&G showed them additional documents that Appellants had not shown them. For example, a former USF&G employee signed an affidavit for Reinsurers, but after reviewing additional documents, issued a counter-affidavit stating that he no longer believed his original affidavit "is accurate." A2464 ¶ 1; A2279-86 at 324:5-325:7; 329:21-330:10; 458:17-461:22 (testifying he was "tricked" into signing an affidavit for ECRA based on "incomplete documentation").

Of course, Reinsurers have proffered no such endorsement for the relevant Treaty years. Appellants rely on extrinsic evidence in the form of a 1981 letter in which (their agent) ETMC's Rentko states: "the renewal agreement applies to all previous years and therefore we should either endorse all old contracts or write to USF&G indicating this fact." A638. Without any evidentiary basis, Reinsurers speculate that this was an "offer[] to forgo formal endorsements to the old treaties." AmRe Br. at 76. But thereafter, the parties actually executed endorsements memorializing the retention increase—and limited those endorsements to post-1962 treaties only. A1939-45. Consistent with this indisputable fact, David Forrest at ETMC, who Mr. Rentko said was responsible for memorializing the parties' agreement on the retention issue (A2211 at 255:10-20), understood that the retentions of *only* post-1962 treaties had been increased. A2330 ¶ 4.

C. Reinsurers Failed To Proffer Clear And Convincing Evidence Of Mutual Mistake Or Fraud To Reform The Unambiguous Treaty At Issue Here

As the trial court recognized, Reinsurers are essentially asking the Court to reform the unambiguous terms of the 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." A93. Indeed, parol evidence is properly considered *only* if Reinsurers are seeking reformation. *Chimart Assocs. v. Paul*, 66 N.Y.2d 570, 573 (1986).

To reform a contract, a party must establish "by clear and convincing evidence" the existence of fraud or mutual mistake. *In re Liquidation of Union Indem. Ins. Co.*, 162 A.D.2d 398, 398 (1st Dep't 1990). Appellants cannot begin to meet this evidentiary standard. To defeat summary judgment, a proponent of reformation must show in "no uncertain terms" what was intended by the parties "free of contradiction or equivocation." *George Backer Mgmt. Corp. v. Acme Quilting Co.*, 46 N.Y.2d 211, 219-20 (1978) (summary judgment granted because "[a]s a matter of law, no showing free of contradiction or equivocation [came] through from the affidavits submitted" in opposition to the motion). *See also Resort Sports Network Inc. v. PH Ventures III, LLC*, 67 A.D.3d 132, 136 (1st Dep't 2009) (same).

The trial court correctly held that Reinsurers failed to "present sufficient evidence to raise an issue of fact" as to either mutual mistake or fraud as a matter of law. A93. Indeed, Reinsurers fall far short of establishing "in no uncertain terms" that the parties intended to increase the retention of the Treaty from $100,000 to $3 million, which is their burden if the Court is to reform the unambiguous Treaty as Reinsurers urge this Court to do.

1. Correspondence in the 1980s demonstrates a strategic decision by Reinsurers to amend only post-1962 treaties

A July 13, 1981 memorandum produced by AmRe confirms that Reinsurers made a conscious decision not to seek to extend the retention increase to pre-1962 treaties:

> [B]ecause 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. Naturally we would like to go back further, but our rationale for doing so becomes less compelling in view of the above mentioned circumstances.

A1946. Then, in an August 5, 1981 memo, the AmRe employee confirms: "As a follow-up to my recent previous memorandum, we have decided not to go back beyond accident year 1962 for purposes of moving to the $3,000,000 retention as respects losses first reported on or after 7/1/81." A1947.

AmRe acknowledges, as it must, that certain of its own documents "suggest[] an internal decision in the Summer of 1981 not to seek to extend such a retroactive increase further back than 1962." AmRe Br. at 78-79. AmRe then misleadingly contends that USF&G's Conwell subsequently advised AmRe in writing on December 16, 1981 that the agreement that had been reached to retroactively increase the retention "include[s] all losses prior to July 1, 1981." AmRe Br. at 79. But AmRe glaringly fails to acknowledge that USF&G's December 16, 1981 letter was in response to a September 18, 1981 letter from AmRe relating to *post-1962 treaties*.

Specifically, by letter dated September 18, 1981, AmRe forwarded to USF&G signed endorsements to treaties covering the period 1962 to 1975. RA496-502.[51] According to AmRe's cover letter, the endorsements serve[d] to

[51] Contract No. 3995-0002-06 covers the years 1962 to 1966 and contract No. 3995-0017-04 covers the years 1966 to 1975. A2563.

formalize [the parties'] agreement." RA496. AmRe's letter further stated that Guy Carpenter was in the process of preparing endorsements covering the period after July 1, 1975 when it became reinsurance intermediary. *Id.* Incredibly, AmRe included in the Appendix on this appeal the September 18 letter as Exhibit A to the Conwell Affidavit *without* the endorsements to the post-1962 treaties that were part of Exhibit A in the affidavit in the record below. *Compare* A2306 with RA496-502.

By letter dated December 16, 1981 from USF&G's Conwell to AmRe's Mobyed, Mr. Conwell "apologize[d] for not returning the endorsements [Mobyed] sent to [Conwell] on September 18th." A2321. Again, all of those endorsements unequivocally relate to *post-1962 treaties*. RA496-502. Mr. Conwell wrote that he forwarded the endorsements to Guy Carpenter for its "review and advice." A2321. While Mr. Conwell added that Guy Carpenter would be revising the endorsements to "include all losses prior to July 1, 1981" (A2321), their previous correspondence makes clear—as Mr. Conwell confirmed (A2305 ¶ 12)—that the endorsements would only reach back to *post-1962* treaties.[52] At no time did Mr. Conwell "ever intend to

[52] Appellants seek to cast doubt on Mr. Conwell's affidavit by citing to a 1988 memo authored by USF&G's Bradley Wallace (who is now deceased), reflecting his then assumption that the parties intended to increase the retentions of pre-1962 treaties. ECRA Br. at 73-74. But Mr. Wallace did not participate in the retention-related negotiations, A2305 ¶ 12, and he reached his initial conclusion by misconstruing the December 16, 1981 letter authored by Mr. Conwell, reading it without regard to the September 18, 1981 letter (enclosing only post-1962 treaty endorsements) to which it was responding. A2304-05. The record demonstrates that Mr. Wallace later came to a correct understanding of the scope of the retention increase. A2241. In 1992,

increase the retentions of pre-1962 treaties to $3,000,000." *Id. See also* RA455-57 at 346:18-348:5 (Conwell deposition testimony).

Moreover, on June 21, 1982, after USF&G proposed alternative wording for the endorsements, AmRe sent a letter to Guy Carpenter reiterating in a broken out list of applicable treaty numbers by year that the retentions of only the post-1962 treaties were to be increased. A2563-64; *see also* A1948-1966 (additional AmRe correspondence memorializing that the retention increase applied only to post-1962 treaties). Further, all of the endorsements reviewed and signed by ECRA over a period of years in the 1980s reflected that *only* the retentions of post-1962 treaties were increased. A1937-38; A2331-40; A2341-44.

2. Correspondence in the 1990s demonstrates that only post-1962 treaties were amended

By letter dated June 17, 1992, Guy Carpenter sent Mr. Rentko of ETMC (ECRA's manager) further revised endorsements for counter-signature. A1928-32. In its letter, Guy Carpenter provided a detailed history of the parties' negotiations with regard to retention levels and explained that, as a result of the 1981 renewal, only the retentions of post-1962 treaties were increased to $3,000,000: "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

Mr. Wallace signed revised versions of endorsements to only post-1962 treaties. A1944-45. And, in 1993, Mr. Wallace applied a $100,000 retention to pre-1962 treaties in connection with the Abbott Labs claim. RA461-62 at 352:21-353:12.

retention." A1928. Mr. Rentko, who participated in the 1981 renewal, wrote in the margin of his copy of the letter that this was "correct." *Id*. On July 20, 1992, Mr. Rentko counter-signed the revised post-1962 endorsements on behalf of ECRA. A1939-45; *see also* A2565-A2577 (Guy Carpenter/AmRe correspondence).

According to Randall White of Guy Carpenter, who was tasked with finalizing the endorsements in 1992, "[e]veryone" at USF&G, ETMC and AmRe was "on the same page. It was back to '62 only." A2042 at 292:11-15.

3. Reinsurers' proffered evidence utterly fails to support a triable issue of fact regarding mutual mistake or fraud

The extrinsic evidence upon which Appellants rely—which is relevant only if the court is scrutinizing a reformation claim (which Reinsurers previously disavowed ever making)—does not, as the trial court correctly held, come close to satisfying the clear and convincing standard to reform a contract based on mutual mistake or fraud. For example:

- Old First Excess: Appellants cite a number of documents in which the parties discuss increasing the retentions of the "old" First Excess treaties. *See* A604; A553; A639-40. The term "old First Excess" refers to treaties issued *after 1962* (which had retentions of $500,000 or $1,000,000)—and not pre-1962 treaties (which had retentions of $50,000 and $100,000). A2302-03 ¶¶ 3-5; *see also* A2165; A2166.

- Abbott Labs/Delaware Insulation: The documents Appellants rely upon concerning Abbott Labs and Delaware Insulation are irrelevant because they pre-date USF&G's actual billing of these claims based on

a $100,000 retention. *See supra* p. 83. Regardless, the documents cited by Appellants do not say what Appellants claim they say. For example, while a 1986 loss advice reflects a $3,000,000 retention (A645), the document relates to reinsurers who subscribed to the 1975 reinsurance contract when the retention was in fact $3,000,000. *Compare* A645 with A2275.[53]

- Handwritten notation: Appellants rely on a December 12, 2001 handwritten note of USF&G's Barbara Jorgenson in connection with an unrelated potential reinsurance claim (the "WABCO claim") in which USF&G's Jim Kleinberg purportedly told her that the retention in the Treaty is $3 million. Am Re Br. at 77-78 and ECRA Br. at 71 (citing A1228). However, Appellants deliberately omit that two days after making the note, Ms. Jorgenson learned that the retention in fact was $100,000, and *corrected the documentation*. RA466-67 at 143:9-144:1; RA401. *See also* RA402; RA403 (additional WABCO documents reflecting the retention as $100,000).[54]

Reinsurers' strained portrayal of the record on the retention issue does not even pass muster under a straightforward summary judgment standard, let alone "in no uncertain terms" establish mutual mistake or fraud, as is required to reform the plain terms of a contract under well-established New York law. Absent clear and convincing evidence of mutual mistake or fraud, the Treaty, which AmRe attached as an exhibit to its complaint and itself acknowledged required USF&G only "to absorb the first $100,000 in loss from

53 Reinsurers' citation to a 1991 Guy Carpenter memo (A646-47) is not competent evidence since, as the author himself attests, he had not participated in the retention negotiations and had no personal knowledge on the retention issue. A2300-01. Moreover, five months after that memo, USF&G wrote to Guy Carpenter stating that the retention under pre-1962 treaties is $100,000 (not $3,000,000). A2077-78.

54 USF&G's decision not to bill Reinsurers in connection with the WABCO claim had nothing to do with the retention amount. RA480-81 at 366:17-367:18.

each accident" as a matter of *undisputed material fact* in its summary judgment papers below (A848 ¶ 57), speaks for itself.

CONCLUSION

For all of the foregoing reasons, USF&G respectfully requests that this Court affirm the Decision and Order of the Appellate Division, First Department, entered on January 24, 2012, which affirmed the Judgment of the Supreme Court, New York County, entered on October 25, 2010, and the Order of the same Court, entered on August 20, 2010 and amended on October 22, 2010, which granted USF&G's motion for summary judgment.

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SIMPSON THACHER & BARTLETT LLP

By: /s/ Mary Kay Vyskocil
Mary Kay Vyskocil
Chet A. Kronenberg
Ryan A. Kane
Jonathan M. Weiss
425 Lexington Avenue
New York, New York 10017
(212) 455-2840

Attorneys for Plaintiffs-Respondents