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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 63
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GRANITE STATE INSURANCE COMPANY,

Plaintiff,

Index No. 653546/11

-against-

CLEARWATER INSURANCE COMPANY (formerly known as Odyssey Reinsurance Corporation, Skandia American Reinsurance Corporation, and Skandia Insurance Company, Ltd., U.S. Branch),

Defendant.

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Ellen M. Coin, J.:

In this declaratory judgment action involving the right to reinsurance coverage, plaintiff Granite State Insurance Company (Granite State) moves following completion of discovery for summary judgment. Defendant Clearwater Insurance Company (Clearwater) cross-moves for summary judgment, for a declaration that it need not indemnify Granite State under the parties' reinsurance contract.

I. Background

Granite State, incorporated in Pennsylvania, with a principal place of business in New York, is a member of the American International Group of insurance companies (AIG). AIG issued dozens of polices of insurance to nonparty Kaiser Aluminum & Chemical Corporation (Kaiser) between 1970 and 1985, for

approximately $574 million in total exposure. Granite State issued the policy herein to Kaiser for excess coverage, effective April 1, 1981 to April 1, 1982 (Kaiser Policy).

Granite State entered into a Casualty Facultative Reinsurance Certificate (Certificate) (O'Sullivan affirmation, exhibit 2) with Clearwater (then known as Skandia America Reinsurance Corporation), a Delaware company, with its principal place of business in New Hampshire, for a reinsurance participation in the Kaiser Policy. Clearwater reinsured many other AIG policies covering Kaiser, as well as reinsuring Kaiser policies issued by non-AIG insurers.

Clearwater, at some point, entered into retrocessionaire contracts (that is, policies of reinsurance on reinsurance policies) with Constellation RE and CX Re (together, Constellation), which covered, among other policies, the Granite State claims under the Certificate.

Hundreds of thousands of bodily injury claims were made against Kaiser during the period in question, for losses arising from exposure to asbestos, from products produced by Kaiser, or used at premises where injured parties were employed. The losses amounted to many millions, if not billions, of dollars.

Kaiser's various insurers disputed coverage. Kaiser commenced litigation in the California courts in May 2000, seeking coverage from its insurers. *See Kaiser Alum. & Chem.*

Corp v Certain Underwriters as Lloyd's London, Case No. 312415 (Cal Super Ct, San. Fran. County) (Coverage Litigation). Granite State and AIG became parties to this litigation in 2000.

Clearwater contends that the AIG companies knew, by 2002 or 2004, from the events in the Coverage Litigation, that the losses would reach well beyond the Kaiser's Policy, so as to surely trigger the Certificate. Clearwater lists a number of documents that allegedly show that AIG knew, at least by 2002 "and certainly no later than 2004," that the losses would reach or exceed the Kaiser Policy. *See* Clearwater memo of law at 3-4.

Granite State and the AIG companies, faced with the projections of massive losses by Kaiser, settled with Kaiser, agreeing to pay the Kaiser Trusts up to the AIG companies' products limit, in quarterly installments over 10 years (Kaiser Settlement). While Kaiser had filed for bankruptcy in 2002, the bankruptcy court approved the Kaiser Settlement, in May 2006.

Payment to Kaiser has been made by Granite State using a "horizontal bathtub methodology," which Granite State defines as a system where "payments are allocated to the policies with the lowest limits first, with policies at the same layer paying evenly at the same time. As a result, no dollars [are] allocated to any higher policies until all lower layer policies [are] exhausted." Granite State memorandum of law in support of motion at 7. Granite State maintains that this is the "industry norm

for mass tort settlements." *Id.*

Granite State did not bill Clearwater under the Certificate until 2010, when payments first began to be allocated to the claims under the Kaiser Policy, using the horizontal bathtub methodology. It is agreed that no specific or formal notice of the probable exhaustion of the Kaiser Policy had ever been made to Clearwater up to that point. Clearwater declined to pay under the Certificate, leading to the present litigation.[1]

Clearwater claims that Granite State unreasonably delayed informing Clearwater of the reasonable likelihood that the Kaiser Policy limits would be reached, causing Clearwater to be substantially prejudiced when Granite State called for payment under the Certificate. Clearwater maintains that Granite State knew many years before Granite State first billed Clearwater that there would be massive losses paid under all of Kaiser's policies, including the Kaiser Policy, and that Clearwater should have known that Granite State expected that the Certificate would be reached.

Clearwater's expert, Paul C. Thomson, III, opines that "any experienced insurance claims professional would have reasonably understood, as early as 2002, that the Kaiser asbestos personal

[1]The billings that are the subject of this action commenced in 2011. The parties settled their dispute over billings issued prior to 2011 (Compl § 12; Plaintiff's Memorandum of Law dated June 19, 2015, n2 at 8).

injury claims may result in a claim under the [Kaiser] policy, and, by no later than 2004, that there would be significant claims under the [Kaiser] Policy." Thomson aff at 5. He further opines that as a result of the Settlement in 2006, "Granite State not only 'reasonably believe[d] that Kaiser asbestos personal injury claims 'would result in a claim against [Clearwater],' it was by then a known certainty." *Id.*

Clearwater claims that Granite State's many years' delay in reporting the Kaiser losses is a breach of the Certificate, which required Granite State unconditionally to "notify [Clearwater] promptly of any event or development which [Granite State] reasonably believes might result in a claim against [Clearwater] under the [Certificate], and to "forward to [Clearwater] copies of such pleadings and reports of investigations as are pertinent to the claim . . . ." Certificate, O'Sullivan aff, exhibit 2, ¶ 3 (a).

The Certificate also provided Clearwater the right to inspect "all books, records and papers of [Granite State] in any way pertinent to the reinsurance provided under the [Certificate], included but not limited to claims in connection therewith." *Id.*, ¶¶ 3 (a), 4. Under the Certificate, doing so would allow Clearwater the option to associate with Granite State in the defense of the underlying claims, if it so chose, an option which was allegedly foreclosed to it under the underlying

facts.

Granite State maintains that even if it were to be shown that its notice to Clearwater was late, Clearwater's disclaimer was, in turn, untimely, and therefore inadequate as a matter of law. Granite State claims that Clearwater originally disclaimed without giving late notice as a reason for the disclaimer, only bringing in the defense two years later by pleading late notice as an affirmative defense in the present action. Granite State relies on California statutory law for its late notice claim. *See* California Insurance Code § 554.

Granite State further argues that an insurer pleading late notice must establish prejudice, and that Clearwater cannot do so. Assuming that Clearwater is required to show prejudice, Clearwater points to the fact that in 2006 and 2007 it entered into "commutation" agreements with its retrocessionaire, Constellation, in which the parties terminated the retrocession contracts in exchange for a stipulated amount from Constellation to Clearwater. New York Insurance Law § 1321 (b) defines a "commutation" as "the elimination of all present and future obligations between the parties, arising from the reinsurance agreement, in exchange for a current consideration. *See Ins. Co. of the State of Pennsylvania v Argonaut Ins. Co.*, 2013 WL 4005109, *5, 2013 US Dist LEXIS 110597, *25 (SD NY 2013) (in a commutation, the reinsurer cedes some of the risk it has

underwritten to its own reinsurer, who is known as the retrocessionaire). Clearwater claims that it never would have commuted the retrocession contract for the amount contracted had it known of the pending Kaiser losses, and the possibility of a claim brought by Granite State against Clearwater under the Certificate.

Granite State responds that under California law, a disadvantageous commutation does not establish prejudice in these situations.

Although millions of dollars were the subject of the various insurance claims underlying this action, in this action Granite State seeks to recover the sum of $733,398.76 from Clearwater.

II. Discussion

Summary judgment is a "drastic remedy." *Vega v Restani Constr. Corp.*, 18 NY3d 499, 503 (2012). "[T]he 'proponent of a summary judgment motion must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to eliminate any material issues of fact from the case.'" *Meridian Mgt. Corp. v Cristi Cleaning Serv. Corp.*, 70 AD3d 508, 510 (1st Dept 2010), quoting *Winegrad v New York Univ. Med. Ctr.*, 64 NY2d 851, 853 (1985). Once the proponent of the motion meets this requirement, "the burden then shifts to the opposing party to produce evidentiary proof in admissible form sufficient to establish the existence of a material issue of fact

that precludes summary judgment and requires a trial." *Ostrov v Rozbruch*, 91 AD3d 147, 152 (1st Dept 2012), citing *Alvarez v Prospect Hosp.*, 68 NY2d 320, 324 (1986). If there is any doubt as to the existence of a triable issue of fact, summary judgment must be denied. *Rotuba Extruders v Ceppos*, 46 NY2d 223, 231 (1978); *Grossman v Amalgamated Hous. Corp.*, 298 AD2d 224, 226 (1st Dept 2002).

The first issue to be determined is the choice of law: between New York law, which Clearwater claims is controlling over the Certificate, and California law, upon which Granite State relies. Initially, Clearwater suggests that Granite State waived the right to argue that New York law does not apply when it chose to use New York law in prior motions before this court. However, this appears to be the first substantive motion Granite State has made in this case, and the application of New York law in earlier, procedural matters is irrelevant. This court finds that Granite State has not waived its choice of law argument. Nor does judicial estoppel apply.

It is established that the law of the forum (here, New York, by choice of the parties), determines the choice of law. *See Padula v Lilarn Props. Corp.*, 84 NY2d 519, 521 (1994). The initial question is "whether there is an actual conflict between the laws of the jurisdictions involved." *Matter of Allstate Ins. Co. (Stolarz-New Jersey Mfrs. Ins. Co.)*, 81 NY2d 219, 223 (1993).

"For an actual conflict to exist, the laws in question must provide different substantive rules in each jurisdiction that are relevant to the issue at hand and have a significant *possible* effect on the outcome of the trial." *TBA Global, LLC v Proscenium Events, LLC*, 114 AD3d 571, 572 (1st Dept 2014)(internal quotation marks and citation omitted).

Regarding Clearwater's claim that Granite State provided late notice of the extent of the Kaiser payments, Granite State notes that California law explicitly recognizes that a reinsurer can obtain "constructive notice" of a potential claim. *See Insurance Co. of the State of Pennsylvania v Argonaut Ins. Co.*, 2013 WL 4005109, *8-9, 2013 US Dist LEXIS 110597, at *25 (SD NY 2013). Granite State maintains that Clearwater obtained constructive notice of the likelihood that the Kaiser Policy would be exhausted by Clearwater's receipt of updates of the progress of the Coverage Litigation. Granite State claims that New York law does not recognize constructive notice in this situation, in "actual conflict" with California law.

Clearwater agrees that New York state law does not allow for constructive notice of a reinsurance claim. Citing *New Hampshire Ins. Co. v Clearwater Ins. Co.* (129 AD3d 99 [1st Dept 2015]), Clearwater shows that under New York law, a cedent[2] company cannot contend that its reinsurer obtained knowledge of the claim

[2]The reinsured party.

through "collateral sources" (*id.* at 117)(such sources "cannot, as a matter of law, meet [cedent's] reporting or notice obligations under the . . . certificate") *Id.* Clearwater also argues that the Certificate itself does not allow for constructive notice, as it provided that Granite State had the express obligation to notify Clearwater "promptly of any event or development which [Granite State] reasonably believes might result in a claim against [Clearwater]." Certificate, ¶ 3.

Thus, the parties agree that there is a conflict on this issue between New York and California law.

It must now be determined which state's law shall apply. "Generally, 'the courts apply the more flexible "center of gravity" or "grouping of contacts" inquiry, which permits consideration of the "spectrum of significant contacts" in order to determine which State has the most significant contacts to the particular contract dispute.'" *Matter of Unitrin Direct/Warner Ins. Co. v Brand*, 120 AD3d 698, 700 (2d Dept 2014), quoting *Matter of Eagle Ins. Co. v Singletary*, 279 AD2d 56, 58-59 (2d Dept 2000). In general, the significant contacts in a case involving contracts are "the place of contracting, negotiation and performance; the location of the subject matter of the contract; and the domicile of the contracting parties." *Matter of Allstate Ins. Co. (Stolarz-New Jersey Mfrs. Ins. Co.)*, 81 NY2d at 227. In reinsurance disputes, the state where the reinsurance

certificate issued and the location where performance is expected, i.e. the place to which the ceding insurer must make its demand for payment, typically control for purposes of choice of law. *AIU Ins. Co. v TIG Ins. Co.*, 934 F Supp 2d 594 (SD NY 2013), *aff'd* 577 Fed Appx 24 (2d Cir 2014).

Granite State argues that factors relevant to this action relate to California. Specifically, the Certificate was "negotiated and issued in California, and its subject matter is a California Risk." Granite State memorandum of law at 12. Granite State's management company in San Francisco handled the policy. Further, Granite State contends that its performance to notify Clearwater of any changes in the underlying insurance policy occurred solely in California.

Clearwater contends that the only states which have an interest in this matter are New York, Clearwater's principal place of business at the time the Certificate was issued, and New Hampshire, then Granite State's principal place of business. Clearwater claims that New York law should govern, since, as it was Clearwater's principal place of business, it was the location of the expected performance of the Certificate.

There is no question that the subject policy was issued in California. According to the Casualty Facultative Reinsurance Certificate, Skandia (a Clearwater predecessor) issued the Certificate at its office in San Francisco to Guy Carpenter &

Company, Granite State's "intermediary" there. The Certificate provides, "Upon receipt by Skandia of satisfactory evidence of payment of a loss for which reinsurance is provided hereunder, Skandia shall promptly reimburse [Granite State] for its share of the loss and loss expense...." (¶ 3[c]). As the Certificate specified no location for Skandia's performance, presumably Granite State would make presentation of such evidence of a loss at the Skandia office which issued the Policy, in San Francisco. Thus, the place of performance would be California. Accordingly, this court finds that the contacts with California in the present matter predominate, so that California law should apply to any issue of law concerning the Certificate in which New York and California conflict.

An initial issue is whether Clearwater waived its right to assert Granite State's alleged delay in notifying Clearwater of the exhaustion of the Kaiser policy, in light of Clearwater's two-year delay in denying coverage on the basis of late notice. Granite State relies on California Insurance Code § 554, which states that "[d]elay in the presentation to an insurer of notice or proof of loss is waived, . . . if [the insurer] omits to make objection promptly and specifically upon that ground." This statute has been found to apply to reinsurers as well as to insurers, who "may invoke the defense of late notice so long as [the insurer] immediately objects to the late notice, and suffers

'actual and substantial prejudice' [internal citation omitted]." *National American Ins. Co. of California v Certain Underwriters at Lloyd's London*, 93 F3d 529, 538 (9th Cir 1996). Regardless, the California Supreme Court has specifically followed the rule of waiver that "an insurer waives defenses to coverage not asserted in its denial only if the insured can show misconduct by the insurer or detrimental reliance by the insured." *Waller v Truck Ins. Exch., Inc.*, 11 Cal 4th 1, 33 (1995).

Granite State has shown no misconduct on Clearwater's part in delaying to state its defense of late notice, and has not established that it detrimentally relied on Clearwater's delay. Therefore, Clearwater cannot be found to have waived its defense that Granite State failed to give prompt notice to Clearwater of the approaching exhaustion of the Kaiser Policy.

As set forth above, California law can be read to allow that a reinsurer may obtain constructive notice of a potential claim by its cedent through events prior to the receipt of formal notice, sufficient to trigger it to act under the reinsurance policy. In the present instance, Granite State supplies several documents it claims advised Clearwater sufficiently of the state of the Kaiser litigations to put Clearwater on inquiry notice that the Granite State policy would likely be exhausted. These documents are contained in the affirmation of Alan J. Sorkowitz, as exhibits I, J, K and L. Granite State claims that these

documents gave Clearwater constructive notice in 1997, 2000, 2003 and 2005.

Upon inspection, this court finds that the documents in question are not sufficient to put Clearwater on notice of the likely exhaustion of the Kaiser Policy so as to involve Clearwater as a matter of law. Although questions of notice may ordinarily be questions of fact for a jury, the documents simply do not specifically relate to Granite State's obligations to Kaiser, much less Clearwater's obligations to Granite State. The letters merely recount the nature of the Kaiser claims, and the fact that many policies of insurance have been affected by the Kaiser litigation. There is nothing in these documents such as might serve to require Clearwater to begin an inquiry into the status of the Granite State policy, in the absence of any correspondence from Granite State itself. That Granite State's possible involvement in the litigations discussed might be found to be "in the air" as a result of the revelations concerning other companies' exposure, is simply not enough to constitute constructive notice to Clearwater that Granite State would invoke the Certificate. As Clearwater expresses it, "[p]roviding general information about an underlying policyholder, and hoping that the reinsurer 'figures it out,' is not what the [Certificate] notice provision requires, and is not what Clearwater expressly bargained and paid for." Clearwater

memorandum of law in opp to motion at 24. As such, Granite State did not promptly notify Clearwater of the claim it is now raising.[3]

The next issue is whether Clearwater was prejudiced by Granite State's late notice. California law requires a showing of "actual and substantial" prejudice stemming from the late notice. *Insurance Co. of State of Pennsylvania v Associated Intl. Ins. Co.*, 922 F2d 516, 524 (9th Cir 1991) (*ICSOP*). The "mere possibility" of prejudice is not sufficient. *Id.* New York law also requires a showing of "material and demonstrab[e]" prejudice where a reinsurer (as opposed to a primary insurer) makes a claim of late notice. *Unigard Sec. Ins. Co. v North Riv. Ins. Co.*, 79 NY2d 576, 584 (1992).

Clearwater claims that it was prejudiced by the fact that it made a disadvantageous commutation with Constellation, which it would not have done had it known of its exposure under the Certificate. Clearwater argues that it would have commuted the Retro Contract so as to "cover the Kaiser losses" under the Certificate, to provide for an adequate case reserve for those losses. Clearwater opposition memorandum to motion at 22. It

[3]Clearwater provides a series of letters from 2006 asking AIG if there were "any additional AIG involvements that we should be put on notice of." O'Sullivan affirmation, exhibit 34. Clearwater received no response to these inquiries, potentially showing that it actually did make reasonable inquiry as to any claim involving the Certificate, to no avail.

claims that because of its ignorance of the upcoming exhaustion of the Kaiser Policy, Clearwater would have received "85% of the value" from Constellation of any reserve Clearwater would have posted and reported. *Id.* at 23.

The California courts have explored the matters which will amount to "actual and substantial" prejudice, as follows:

> "under California case law, the only prejudice sufficient to allow an insurer to avoid liability based on late notice is found in those cases where the insurer actually demonstrated that there was a substantial likelihood that it could have either defeated the underlying claim against its insured, or settled the case for a smaller sum than that for which its insured ultimately settled the claim."

ICSOP, 922 F2d at 524. This principle does not include a disadvantageous commutation.

In *ICSOP*, the reinsurer claimed that is was prejudiced by, among other reasons, the failure to make its own claim for reinsurance from its retrocessionaire, which went bankrupt before notice was obtained; that is, a failure to make a commutation. The *ICSOP* Court found this to be a "collateral matter," and stated that it had found no case law "to support the proposition that such collateral matters may constitute prejudice so as to relieve an insurer from its liability under an insurance contract." *Id.* at 525.[4]

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[4]This court notes that a New York federal court declined to follow *ICSOP* on the issue of whether a disadvantageous commutation may be considered prejudice as a result of late notice. *See Insurance Co. of State of Pennsylvania v Argonaut*

Thus, Clearwater has failed to allege the "actual and substantial" prejudice that would allow it to avoid its obligations under the Certificate, despite Granite State's demonstrable failure to give timely notice to Clearwater. While Clearwater suggests that Granite State's breach of the Certificate was the result of bad faith, recklessness and/or gross negligence, so as to relieve Clearwater from having to establish prejudice, no more than conclusory statements are made to support these contentions, which do not serve to change the result herein.

Clearwater raises additional arguments, contending that Granite State allegedly breached the Certificate, so as to relieve Clearwater from performing, regardless of the notice issue. It argues that Granite State failed to satisfy two conditions precedent to coverage under the Certificate.

The first such claimed breach is of an alleged duty to "actually pay" any amounts in settlement of the Kaiser claims. This argument is based on the definition of "loss" in the Certificate, which is "only such amounts as are actually paid by [Granite State] in settlement of claims or in satisfaction of awards and judgments." Certificate, ¶ 3 (d).

Ins. Co., 2013 WL 4005109 (SD NY 2013), 2013 US Dist LEXIS 110597, *40, n 13. The court in *Argonaut* held that *ICSOP* be confined to its facts. *Id.* at *12, n 13. However, this court disagrees, and applies California's decisions to the matter at hand.

Clearwater maintains that discovery shows no evidence that Granite State made any of the required payments; rather, the payments were allegedly made by other entities related to Granite State. Clearwater argues that Granite State has failed to provide any evidence in discovery to show that any part of these payments were made on Granite State's behalf, or that Granite State reimbursed these entities for the payments they made. Thus, Clearwater maintains that Granite State did not "actually pay" for anything, and deserves no recompense.

Granite State identifies the entities in question: ICSOP, which Granite State calls its "sister company" (Clearwater memorandum of law in opposition to cross-motion at 24), and Resolute, its claims administrator. *Id.* Granite State posits that the term "actually paid" in the Certificate does not mean that the payments had to be made from Granite State's checking account.

This court finds Clearwater's reading of the Certificate to be overly simplistic. Granite State has established that all of the required payments were made under the Kaiser policy up to the exhaustion of the policy, when Clearwater's obligations were triggered. There is no reasonable claim that other companies gifted Granite State with the payments due under the Kaiser Policy. Granite State's expert concludes that the language "actually paid" is meant to be distinguished from "are to be

paid," meaning claims which are pending, and not a reference to where the money comes from. Clearwater offers no evidence that would contradict this. Therefore, under the circumstances herein, the claims were "actually paid," so as to satisfy the meaning of the Certificate.

Clearwater next argues that Granite State breached the Certificate's warranty of retention. Under the Certificate, Granite State "warrant[ed] that it shall retain for its own account, subject to treaty insurance only, if any, the amount specified on the face of th[e] Certificate." Certificate, ¶ 2. This amount specified in the Certificate was "$5,000,000 of the $35,000,000 limit of the Granite State Policy." Linda Martin Barber (Barber) affidavit, ¶ 27.

Clearwater claims that Granite State did not retain any portion of the risk, because it entered into an inter-pooling agreement with the other AIG companies, "pursuant to which 100% of Granite State's liability under the Policy was transferred to and assumed by other AIG companies," and therefore, "Granite State did not retain any of the liability under the policy 'for its own account,' 'indisputably' breaching the Certificate's warranty of retention . . . ." Clearwater memorandum of law in support of cross-motion at 12, referring to O'Sullivan affidavit, exhibits 38, 39 and 40. This court has found that for discovery purposes, "Granite State's payment of the retention amount is a

condition precedent to Clearwater's payment under the Certificate . . . ." Decision dated July 14, 2014, O'Sullivan affidavit, exhibit 30 at 5-6.

Granite State provides an expert, Barber, who opines that "as a matter of insurance and reinsurance custom and practice, an inter-company pooling agreement among affiliates is not considered a violation of a retention warranty" because the inter-pooling practice serves as an "incentive to underwrite carefully," which is the purpose of a warranty of retention. Barber affidavit, ¶ 28. Therefore, "industry custom and practice is to disregard inter-company pooling agreements when considering whether a retention warranty has been met." *Id.* Clearwater has not provided any expert testimony as to the meaning of the requirement of a warranty of retention.

Under New York law, evidence of custom and usage "may not be interposed to alter, vary or contradict unambiguous contractual provisions or modify or change legal obligations assumed by the parties under their contracts." *Pink v American Sur. Co.*, 283 NY 290, 296 (1940). However, California courts approach contract interpretation from a very different perspective. In California,

> "The fundamental goal of contractual interpretation is to give effect to the mutual intention of the parties. The mutual intent to which the courts give effect is determined by objective manifestations of the parties' intent, including the words used in the agreement, as well as extrinsic evidence of such objective matters as the surrounding circumstances under which the parties negotiated or entered into the contract; the object,

> nature and subject matter of the contract; and the subsequent conduct of the parties."

Morey v Vannucci, 64 Cal App 4th 904, 912 (1998)(internal citations and quotation marks omitted). In contrast to New York law, "it is reversible error for a trial court to refuse to consider such extrinsic evidence on the basis of the trial court's own conclusion that the language of the contract appears to be clear and ambiguous on its face." *Id.* In such cases, an apparently unambiguous contract may contain "a latent ambiguity" which "may be exposed by extrinsic evidence which reveals more than one possible meaning to which the language of the contract is yet reasonably susceptible." *Id.*

In the present matter, the inter-pooling agreements might indicate that Granite State did not "retain for its own account, subject to treaty insurance only, if any, the amount specified on the face of th[e] Certificate," as required by the Certificate. However, the evidence of custom and usage indicates a latent ambiguity of what the parties intended the warranty of retention to entail. As such, there is a question of fact as to whether Granite State breached its warranty of retention, which cannot here be determined.[5]

Clearwater also argues that Granite State's billings are

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[5]However, Granite State's argument that the inter-pooling of the AIG policies somehow changes the nature of the facultative policies into treaty insurance, so as to invoke the exception in the policy language, is without merit.

"unsupported and void," (Clearwater memorandum in opp to summary judgment at 30), and need not be paid, as Granite State has failed to demonstrate that the amounts allocated under the policy were "actually covered" by the policy. This argument relies on the definition of "loss" in paragraph 3 (f) in the Certificate as "only such amounts as are actually paid by [Granite State] in settlement of claims, or litigation of claims, awards or judgments . . . ." In short, Clearwater purports to challenge the propriety of Granite State's allocations of insurance proceeds to the various underlying claims.

The discussion involves whether or not the Certificate contains a "follow the settlements" clause or intent, or a "following form" clause. A follow the settlements doctrine[6] "insulates liability determinations from challenge by a reinsurer unless they are fraudulent or in bad faith." *Lexington Ins. Co. v Clearwater Ins. Co.*, 28 Mass L Rptr 519, 2011 WL 3715546, *4, 2011 Mass Super LEXIS 127, *11 (Super Ct, Mass 2011). This results in a system wherein a reinsurer cannot "second guess[]" allocation decisions by its cedent, and must literally follow the underlying settlements in paying out under the reinsurance policy. *Id.* Thus, Clearwater could not challenge Granite State's allocations.

[6]Sometimes used interchangeably with the term "follow the fortunes."

On the other hand, a "following form" clause is meant "to achieve concurrency between the reinsured policy and the policy of reinsurance, thereby assuring the ceding company, that by purchasing reinsurance, it has covered the same risks by reinsurance that it has undertaken on behalf or the original insured under its own policy [internal citation and quotation marks omitted]." *New Hampshire Ins. Co. v Clearwater Ins. Co.*, 129 AD3d at 112. Thus, a reinsurer can question the applicability of payments a cedent has made under the reinsured policy, and need not just "follow the settlements" of the cedent.

The clause in question states, as both sides agree, that Clearwater's liability "shall follow [Granite State's] liability in accordance with the terms and conditions of the policy reinsured hereunder." Certificate, ¶ 1.[7] While the parties argue about the collateral estoppel effect of either the *Lexington* case or the *New Hampshire Ins. Co.* case quoted above, in which Clearwater was a defendant, such argument is unnecessary. Neither case would apply to Granite State, which was not a party to either action.

[7]The parties agree as to the language of the Certificate, but the copy of the Certificate upon which each party relies, and which Granite State describes as "clearly" making Granite State's position, is all but clear (Plaintiff's Reply Memorandum of Law at 18). The applicable language is unreadably torn and creased, and is in minuscule type on a very short document. It is amazing that hundreds of thousands of dollars can ride on such a flimsy and poor reproduction of the critical document.

This court finds that the language of the Certificate contained a following form clause. As noted in *New Hampshire Ins. Co.*, one would expect follow the settlement clauses to "employ language referring in some way to the cedent's claims handling decisions," such as the use of the terms "settlement," "compromise," "payment," "allowance" or "adjustment." *New Hampshire Ins. Co.*, 129 AD3d at 111. Absent such directions, the reinsurer is not bound to accept the cedent's allocations. To the extent that the *Lexington* court (28 Mass L Rptr 519, 2011 WL 3715546, 2011 Mass Super LEXIS 127) and the court in *Utica Mut. Ins. Co. v Clearwater Ins. Co.* (2016 WL 254770 [ND NY 2016]) disagree, this court begs to differ.

The California case of *Zenith Ins. Co. v O'Connor* (148 Cal App 4th 998 [2007]) is not to the contrary, and does not aid Granite State. In *Zenith*, the court found that a follow the settlements clause could be read into a reinsurance contract which included, as does the contract here, language to the effect that "Zenith's liability 'shall fully follow' that of [cedent] Royal." *Id.* at 1002. But the *Zenith* reinsurance contract also contained language indicating that "Royal had the right and duty, *in its sole discretion*, to make such settlements *as it deemed expedient* in accordance with the provisions of the underlying policies." *Id.* Thus, the *Zenith* reinsurance contract went far beyond the instant in describing the cedent's right to handle the

claims without challenge, as would a follow the settlements clause. As a result, Clearwater may challenge Granite State's allocations of insurance proceeds to the underlying claims, on a theory that Granite State cannot prove that the losses it allocated to the Certificate were "actually covered" by the Certificate.[8]

This does not conclude the matter in Clearwater's favor, however. The matter of the propriety of Granite State's allocations with regard to its obligation under the Certificate raises material issues of fact, requiring resolution at trial.

In conclusion, there are questions of fact as to whether Granite State breached its warranty of retention, and as to whether Granite State paid losses which were not "actually covered" under the policy, so as to obviate Clearwater's obligation to pay for such losses. As such, the motion and cross-motion must be denied.

Accordingly, it is

ORDERED that the motion of plaintiff Granite State Insurance Company for summary judgment is denied; and it is further

[8]Granite State's expert's opinion that it is industry custom to use a follow the form approach to reinsurance contracts, regardless of the contract language, is not sufficient to create a latent ambiguity in the Certificate's language.

ORDERED that the cross-motion of defendant Clearwater Insurance Company for summary judgment is denied.

Dated: June 17, 2016

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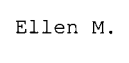

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