UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF VERMONT

Columbia Casualty Company, American Re-Insurance Company, Plaintiffs,	:	
v.	:	File No. 2:05-CV-199
TransFin Insurance Limited, Defendant,	:	
TransFin Insurance Limited, Counter-Plaintiff,	:	
v.	:	
Columbia Casualty Company, American Re-Insurance Company, Counter-Defendants	:	

OPINION & ORDER

(Documents 129, 133, 142, 152, 180, 206 & 225)

On August 1, 2001, a Ford Expedition driven by Marian Kemp and occupied by her four children, Melanie Prud'homme, Lillian Kemp, Kitti Kemp, and Lashara James, was struck by a Kansas City Southern Railroad ("KCSR") freight train at a railroad crossing in Arcadia, Louisiana. As a result of this tragic accident, Kitti Kemp died. Marian Kemp suffered severe injuries including a brain injury leaving her in a semi-comatose state. The other children also suffered severe - albeit less debilitating - injuries.

In June 2002 and August 2002, two lawsuits ("Louisiana I & II") were filed against KCSR in Louisiana to recover for the death and injuries suffered by the occupants of the car. While these suits were pending, a similar lawsuit was filed in Missouri on November 18, 2003. On October 27, 2006, during jury deliberations the parties settled the Missouri lawsuit. On January 5, 2007, KCSR paid $37.5 million to settle all the lawsuits for the Kemp accident. The case *sub judice* involves a dispute between an insurer and its reinsurers about coverage for this accident. The central issue is whether notice of the accident was timely under the terms of the various policies.

Pending Motions

On July 11, 2005, Plaintiffs Shrewsbury Underwriting Capital (Bermuda) Limited ("Shrewsbury"), Gerling Konzern Allgemeine Versicherungs A.G. ("Gerling"), Columbia Casualty Company ("Columbia") filed this diversity action against TransFin Insurance Limited ("TransFin"), American Re-Insurance Company ("American Re"), and Lexington Insurance Company ("Lexington"), seeking a declaratory judgment that no reinsurance coverage exists for claims arising from the accident ("Kemp claims"). American Re and Lexington were realigned as Plaintiffs on September 8, 2005.[1] American Re subsequently joined Plaintiff Reinsurers in seeking a declaration of no reinsurance coverage and also asserted a breach of contract claim based on TransFin's failure to assert and pursue coverage defenses against its insured.[2]

The case is currently before this Court on Columbia's motion for summary judgment (Doc. 129), Plaintiffs' (collectively as "Reinsurers") joint motion for summary judgment (Doc. 133),[3] American Re's motion for summary judgment (Doc. 152), TransFin's motion for partial summary judgment (Doc. 142),[4] Reinsurers' motion to strike TransFin's summary judgment evidence (Doc. 180), American Re's motion to strike TransFin's summary judgment evidence (Doc. 206), and American Re's motion to amend the pleadings (Doc 225).

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[1] On November 17, 2006, Lexington and Transfin's joint motion for dismissal of all claims between them was granted with prejudice. (Doc. 210). On January 22, 2007, Shrewsbury, Gerling, and Transfin's joint motion for dismissal of all claims between them was granted with prejudice. (Doc. 215)

[2] American Re also raised a justiciability issue that became moot upon the Kemp claims settling, triggering American Re's condition precedent to reinsurance coverage.

[3] American Re joins only in Sections III.B and III.C.

[4] Transfin moves for summary judgment on all four counts in Columbia's complaint (Doc. 1-1) and counts I-V of American Re's complaint. (Doc. 84-3). Count VI of American Re's complaint deals with the '03 policies under which TransFin does not seek coverage.

For the following reasons, Columbia's motion is DENIED, the joint motion is DENIED, American Re's motion is DENIED, TransFin's motion is GRANTED, the motions to strike are DENIED, and American Re's motion to amend the pleadings is DENIED.

BACKGROUND[5]

Kansas City Southern

Kansas City Southern Industries, Inc. ("KCS") is a holding company. Two of its subsidiaries include KCSR and Transfin. KCS is headquartered in Kansas City, Missouri.

Transfin Insurance Ltd.

On August 1, 1991, Alexander Insurance Managers ("AIM"), the Burlington, Vermont affiliate of insurance broker Alexander & Alexander, Inc., with which KCS already had a relationship, agreed to assist KCS in forming a Vermont captive insurance company, initially for the purpose of insuring rail property, with the intention to fully reinsure this risk. AIM created, organized, administered and operated captive insurance companies in various jurisdictions, including Vermont. In September 1991, Transfin became a Vermont captive insurer. Transfin was

[5] The parties have submitted statements of disputed and undisputed material facts. L.R. 7.1(c).

organized for the purpose of writing insurance and contracting for reinsurance as a captive insurance company pursuant to Title 8, Vermont Statues Annotated, Ch. 141.

At the time it was formed, Transfin provided property insurance directly to its sister companies, including KCSR, and its parent, KCS. As a "pure" captive insurance company under Vermont law, Transfin only insures risks of its parent and affiliated companies or controlled affiliated companies. Transfin issued the policies and ceded all or a portion of the risk it retained to various U.S. or internationally-based reinsurers.

The Transfin Excess Policies

On June 1, 1998, TransFin issued two layers of excess liability coverage to KCSR.[6] Both excess policies were effective from June 1, 1998 to May 31, 2001, extended by endorsement to May 31, 2002 (hereinafter the "98-02 TransFin policies"). The first layer policy provides $22 million of coverage for claims made in excess of $3 million ($2 million in KCSR self-insurance and $1 million in accident retention). The second layer policy provides $25 million in coverage to KCSR in excess of $25 million ($22 million of

[6] The Court refers to KCS and KCSR interchangeably except where the difference is material.

first layer, $2 million of self-insurance, and $1 million in accident retention). Accordingly, Transfin provided a total of $47 million in excess liability insurance to KCSR. TransFin obtained reinsurance from the Reinsurers for this excess liability coverage.

The 98-02 TransFin Policies' "Conditions" section contains two provisions relevant to this case.

<u>Condition 3</u> "Notice of Accidents and Claims":

> (i) The Insured [KCSR] must notify Underwriters [TransFin] of those Accidents on which a value on the Insured's liability equal to or greater than the amount [$1 million] stated in Item 5 of the Declarations is established in accordance with Condition 4. Accident Valuation. Such notice must be received by Underwriters within 120 days of the value being established.
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> If Underwriters receive notification in accordance with the above they will treat all Claims which arise out of the notified Accident and which are made against the Insured within 60 months from the first date on which the Insured by its Claim Agent was aware of the Accident or the expiry date of this Policy, whichever is the earlier, as made on the first date on which the Insured by its Claim Agent was aware of the Accident or the expiry date of this Policy, whichever is the earlier.
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> (ii) Insured must also give immediate notice to Underwriters whenever the Insured has information from which the Insured should reasonably conclude that a Claim, alone or in combination with any other Claims, may deplete the each Accident retention and any remaining underlying amount by 50% or more [$1.5

million].

For purposes of this Condition 3.(ii) the Insured will notify Underwriters on the assumption that the Insured is liable and further is liable for any amount claimed.

Condition 4 "Accident Valuation":

The Insured shall establish a value on an Accident giving due consideration to each of the following criteria:

(i) the reasonable settlement or judgment value of the claimed or known injuries and/or property damage;

(ii) the probable liability of the Insured (the fact of reporting or not reporting an event shall not be an admission by the Insured or Underwriters that the Insured or Underwriters is/are or may be in fact liable to any party);

(iii) the probable or actual jurisdiction, governing law, court and counsel involved in any pending or possible litigation;

(iv) such other factors as may be relevant to the specific circumstances of such Accident which tend to increase the value of the Insured's liability for the Accident;

Any value so established should reflect the amount payable by the Insured without discount to present day value.

The Reinsurance Policies and Certificates

Reinsurance is intended to permit primary insurers to spread out their loss to prevent catastrophic loss from falling on a single insurer. Unigard Sec. Ins. Co., Inc. v. N. River Ins. Co., 4 F.3d 1049, 1053 (2d Cir. 1993). Reinsurance occurs when a primary insurer (the "ceding insurer") "cedes" all or part of the risk relating to a policy, or a group of policies, to a reinsurer. Any portion of risk not "ceded" is "retained." The relationship created between reinsurer and ceding insurer is one of strict indemnification not liability. Thus, a reinsurer is not in privity with the insured of the underlying policy, but rather with the ceding insurer, or the "reinsured." See Travelers Indem. Co. v. Scor Reinsurance Co., 62 F.3d 74, 76 (2d Cir. 1995). As such, reinsurers do not duplicate the functions of the ceding insurer by examining risks, receiving notice of losses from the original insured, or investigating claims. See Unigard, 4 F.3d at 1054. Rather, to set premiums, reserves, and to decide whether to participate in defense of a claim, reinsurers rely on their common interests with the ceding insurers and on an industry custom of utmost good faith, particularly in the sharing of information. Id.

TransFin obtained full facultative[7] reinsurance in the London and U.S. markets for its $47 million in excess liability coverage. Together, plaintiffs American Re and Columbia provided 37% coverage of the first layer of TransFin's 98-02 excess liability policies and 31% of the second layer. American Re's share for both layers was approximately $8.2 million, while Columbia's share was approximately $2.6 million.

Shrewsbury and other underwriting members of Lloyd's syndicates issued two reinsurance policies, which served as lead policies for Columbia's reinsurance certificates. Copies of the 98-02 TransFin policies were included in the lead London policies and the Transfin policy terms were itemized in the reinsurance policies' tables of contents. Specifically, Columbia listed the London reinsurance policies on the Columbia certificates issued to TransFin, agreeing to "further indemnify [TransFin] in accordance with the applicable insuring agreements of the lead insurance." (Doc. 150, at Tab 17, at 397).

On the other hand, American Re issued reinsurance

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[7] There are two basic types of reinsurance policies: facultative and treaty. Unigard, 4 F.3d at 1053. In facultative reinsurance, the ceding insurer reinsures a particular insurance policy. Id. at 1054. Treaty reinsurance, on the other hand, covers specified classes of ceding insurer's policies. Id.

certificates (the "American Re Certificates") to TransFin using its own policy. Two conditions for coverage from the American Re certificates are relevant.

General Condition 1 provides:

> The Reinsurer [American Re] agrees to indemnify the Company [TransFin] against losses or damages which the Company is legally obligated to pay with respect to which Insurance is afforded during the term of this Certificate under the policy reinsured, subject to the reinsurance limits and coverage shown in the Declarations. The Reinsurer shall not indemnify the Company for liability beyond circumscribed policy provisions, including but not limited to punitive, exemplary, consequential or compensatory damages resulting from an action of an insured or assignee against the Company. The Company warrants the copy of the policy forwarded to the Reinsurers to be a true and complete copy of the said policy, and agrees to notify the Reinsurer promptly of any changes made therein, provided that such changes shall not be binding upon the Reinsurer until accepted thereby. Nothing contained herein shall in any manner create any obligation of the Reinsurer or establish any rights against the Reinsurer in favor of the direct insured or any third parties or any persons not parties to this Certificate of Reinsurance.

General Condition 4 provides, in pertinent part:

> The Company [Transfin] shall advise the Reinsurer [American Re] promptly of any claim and any subsequent developments pertaining thereto which, in the opinion of the Company, may involve the reinsurance hereunder. The Company has the obligation to investigate and defend claims or suits affecting this reinsurance and to pursue such claims or suits to final determination. The Company, when so requested, will afford the Reinsurers an opportunity to be associated with the Company, at the expense of the Reinsurers, in the defense or control

> of any claim, suit or proceeding involving this reinsurance, and the company and the Reinsurer shall cooperate in every respect in the defense and control of such claim, suit or proceeding.

(Doc. 154, at ¶ 17).

Kemp Claim Chronology

1. The relevant TransFin excess policies were for the period June 1, 1998 - May 31, 2002.

2. The Kemp accident occurred on August 1, 2001.

3. On or about August 6, 2001, KCSR was notified by letter that attorney Belton was representing the Kemps.

4. On June 13, 2002, the Louisiana I lawsuit was filed against KCSR. On June 19, 2002, Louisiana I was served on KCSR's registered agent in Louisiana and forwarded to TransFin.

5. On July 11, 2002, KCS set a reserve of $50,000 for Louisiana I.

6. On August 1, 2002, the Louisiana II lawsuit was filed against KCSR. On August 5, it was served on KCSR and forwarded to TransFin.

7. On September 24, 2002, KCS set a reserve of $50,000 for Louisiana II.

8. On November 18, 2003, the Missouri lawsuit was filed against KSCR and forwarded to TransFin.

9. On December 19, 2003, KCSR and TransFin through their claims handling representative Lockton Companies, Inc. sent notification of the Kemp accident to certain Reinsurers under the reinsurance policies then in force (2003-2004 policy period).

10. On January 16, 2004, KCS increased its reserve for the Kemp claims to $1,030,000.

11. On May 27, 2004, Lockton provided written notice to Columbia and American Re of the Kemp accident.

12. On September 28, 2004, KCSR was advised by its outside counsel in the Missouri lawsuit of the possibility of high exposure.

13. On October 4, 2004, KCS increased its reserve for the Kemp claims to $3 million.

14. On October 14, 2004, KCSR met with TransFin's Reinsurers and discussed the Kemp claims.

15. On October 27, 2006, the Kemp claims were settled during jury deliberations.

16. On January 5, 2007, KCSR paid $37.5 million to settle the Kemp claims.

DISCUSSION

I. Standard of Review

Summary judgment should be granted only if "there is no genuine issue as to any material fact and [therefore] the moving party is entitled to a judgment as a matter of law," Fed. R. Civ. P. 56(c). The moving party bears the initial burden of showing an absence of any genuine issue of material fact. Feingold v. New York, 366 F.3d 138, 148 (2d Cir. 2004) (citing Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986)). In ruling on a motion for summary judgment, "the court must resolve all ambiguities and draw all reasonable inferences in favor of the party against whom summary judgment is sought." Winter v. United States, 196 F.3d 339, 346 (2d Cir. 1999) (citing Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 255 (1986)). Further, "[c]redibility assessments, choices between conflicting versions of the events, and the weighing of evidence are matters for the jury, not for the court on a motion for summary judgment." Fischl v. Armitage, 128 F.3d 50, 55 (2d Cir. 1997).

The parties agree that Vermont has the most significant relationship with the reinsurance contracts. Thus the Court must apply Vermont law. The question of whether a contract term is ambiguous and "construction of the language of insurance contracts [are] question[s] of law" for a court to decide. Fireman's Fund Ins. Co. v. CNA Ins. Co., 177 Vt. 215, 220 (2004). Traditional contract interpretation rules apply equally to reinsurance contracts. Prof'l Consultants v. Employers Reinsurance Co., 2006 WL 751244, *3 (D. Vt. Mar. 8, 2006) (citing 1A Couch on Ins. § 9:13 (3d Ed. 2005). As such, insurance policies must be construed according to their terms and the evident intent of the parties as expressed by the policies' language (the "four corners" test). Fireman's Fund Ins., 177 Vt. at 220. Disputed terms are given their "plain, ordinary and popular meaning." Id. When inquiring into the existence of an ambiguity, a court may consider extrinsic evidence concerning the circumstances surrounding the making of the agreement. Isbrandtsen v. N. Branch Corp., 150 Vt. 575, 578 (1988). The mere fact that a provision is disputed, however, does not render the language ambiguous. Id. at 580. Rather, "[l]anguage is ambiguous when it is capable of more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement."

Prof'l Consultants, 2006 WL 751244, at *3 (internal citations omitted).

In this case, although the parties agree that the reinsurance and excess insurance policy terms are unambiguous, they dispute their interpretation and the scope of coverage available under the policies. The Reinsurers argue that there is no coverage for the Kemp claims under the 98-02 TransFin policies based on KCSR's violation of the notice provisions in Condition 3. Similarly, the Reinsurers also deny coverage based on TransFin's notice to them. The issues for the Court to decide are whether (1) the 98-02 TransFin policies provide coverage for the Kemp claims; (2) TransFin met its notice obligations to the Reinsurers; (3) American Re should be permitted to amend its pleadings regarding punitive damages; and (4) strike certain TransFin summary judgment evidence.

II. Coverage under 98-02 TransFin Policies

The terms of the lead reinsurance and incorporated 98-02 TransFin policies provide the scope of coverage Columbia agreed to reinsure.[8] In addition, the American Re

[8] The following form clause, "***subject to the same terms and conditions as the original Insurance provided by the Reinsured***" (emphasis added) from the lead reinsurance policies (upon which Columbia's certificates are based) "obliges the reinsurer to indemnify the ceding company fully within the scope of the reinsured risk when the claim falls within the scope of that risk as a matter

certificates of reinsurance provide reinsurance coverage for claims TransFin is legally obligated to cover. See Condition 1 of American Re certificates. Simply put, if TransFin is not legally obligated on the Kemp claims, neither are the Reinsurers. Therefore determining whether the 98-02 TransFin polices provide coverage for the Kemp claims is the first step in deciding whether there is reinsurance coverage.

The Reinsurers contend that KCSR made no claim before the expiration of the 98-02 TransFin policies and, alternatively, that KCSR did not meet Condition 3, Notice of Accidents and Claims, in order to take advantage of the relation-back procedure for claims made after the expiration of the policies. TransFin responds that (1) a claim was made during the policy period; (2) KCSR met its Condition 3 obligation, making the Kemp claims covered under the 98-02 policy; and (3) even if notice to TransFin was late, TransFin suffered no prejudice.

The 98-02 TransFin policies provide coverage if a claim is properly made by either of two methods. The first

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of law (subject to exclusions explicitly delineated within the certificate of reinsurance)." Aetna Cas. and Sur. Co., v. Home Ins. Co, 882 F. Supp. 1328, 1349 (S.D.N.Y. 1995). Here, KCSR must comply with the notice and valuation procedures in order for the Kemp claims to fall within the scope of coverage under the 98-02 TransFin policies.

method is found in the section entitled "COVERAGE" and requires that a claim for personal injury resulting from an accident be made by the injured party to the insured in writing during the policy period. The second method is Condition 3(i) Notice of Accidents and Claims, which allows a claim made after the expiration of the policy to be covered so long as the Underwriters [TransFin] are notified of the Accident according to a certain procedure. In addition Condition 3(ii) imposes an obligation to give notice of a claim when the Insured [KCSR] receives certain information for the claim to be covered under the policy. The Court finds that no claim was made during the policy period, but that there is coverage pursuant to Condition 3.

A. Claim Made During Policy Period

The relevant policy language provides: "Underwriters agree . . . to indemnify the Insured . . . for damages in respect of a Claim which is first made in writing against the Insured during the period of this Policy set out in Item 6 of the Declarations[9] and which arises solely by reason of: b) Personal Injury . . . resulting from an Accident." (Doc. 150, at TAB 12, at 723). The term "Claim" is defined as

[9] June 1, 1998 through May 31, 2002 [extended by Endorsement One of TransFin 98-02 policies and Eleven of 1005 reinsurance policy.]

"any written demand received by the Insured for damages covered by this Policy, including the service of suit, institution of arbitration proceedings or receipt of any attorney's lien." (Id. at 735). The parties agree that the accident giving rise to the Kemp claim occurred during the policy period and caused personal injuries. The inquiry then is whether a claim, as defined above, was made on or before May 31, 2002, when the TransFin policy expired.

TransFin argues that a letter dated August 6, 2001 from John Belton, an attorney for the Kemp family, meets the requirement of a claim made in writing during the policy period. (Doc. 146, at 6). The letter was sent to KCS outside counsel Art Carmody and KCS Claims Agent Johnny Killebrew and stated in pertinent part that Belton "had been retained by Calvin Kemp in connection with the severe injuries suffered by his wife and children." The parties agree that there was no demand for damages in the Belton letter and that the earliest lawsuit filed against KCSR arising from this accident was on June 13, 2002, after the expiration of the policy period. Similarly, no arbitration proceedings were ever instituted. Although TransFin contends that the Belton letter may only be construed as an effort to recover money, the evidence belies this conclusion. Namely, the individuals who received the letter, Carmody and Killebrew, testified that the letter did not convey any type of demand on KCSR.[10] Thus, the only way the Belton letter can constitute a "Claim" as defined in the policies is if it can be considered an attorney's lien.

The Reinsurers contend that an attorney's lien is a creature of statute in Louisiana (La. Rev. Stat. Ann. § 37:218) and that to create an attorney's lien for his fees, Belton must first have had a fee agreement with the Kemps. La. Rev. Stat. Ann. § 37:218 (2006) ("By written contract signed by his client, an attorney at law may acquire as his fee an interest in the subject matter of a suit"). Here, there is no evidence of a contingency agreement between Belton and the Kemps in Belton's letter or elsewhere. Further, because Belton is a Louisiana attorney, any lien he asserts must adhere to the Louisiana statute.

TransFin has failed to point to specific contrary evidence to the requirements under Louisiana law for creation of an attorney's lien. TransFin offers deposition

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[10] Specifically, Carmody testified that "the [Belton] letter does not contain any specific demand for money or to do or not do anything else." Doc. 150, at TAB 30, 50: 7-10. Likewise, when asked whether he interpreted the Belton letter as making any demand on KCSR, Agent Killebrew answered "No." Doc. 150, at TAB 27, 137: 21-23.

testimony that Carmody considered the Belton letter an attorney's lien. (Doc. 143-1, at 6; Doc. 150, at TAB 30, Carmody Depo, at 50: 14-19). Alternatively, in its opposition to American Re's summary judgment motion, TransFin re-defines the word "Claim" to its common sense usage, which substantially broadens the policy definition of claim. In addition, TransFin contends that whether Belton perfected his lien through recordation and ultimately could sustain it against KCSR is irrelevant to whether KCSR received an attorney's lien.

First, because "Claim" is defined in the policy that all parties agree is unambiguous, the Court need not consider the common sense usage discussed in other cases. Second, while perfection of an attorney's lien is not required, the existence of a contingency fee contract is a prerequisite under the Louisiana statute and the Belton letter provided no evidence that he had such a contract with the Kemp claimants. Finally, given that Louisiana has a statute outlining the method for securing an attorney's lien, the mere fact that Carmody, also a Louisiana attorney, considered the Belton letter to be an attorney's lien is insufficient. Because the Belton letter does not conform to the policy definition of "Claim," the Court finds that no claim arising from the Kemp accident was made before the May 31, 2002 expiration of the 98-02 TransFin policies.

B. Notice to TransFin

Since the Belton letter did not meet the definition of claim under the TransFin policies, in order for the Kemp claims to be covered under the TransFin policies, KCSR must have complied with second method of claim coverage set forth in Condition 3. NOTICE OF ACCIDENTS AND CLAIMS. As addressed supra, Condition 3 is a term from the 98-02 Transfin policies requiring KCSR to adhere to certain notice obligations for the Kemp claims to be insured and reinsured. The Court finds KCSR complied with both subsections of Condition 3 and therefore retains coverage for the Kemp claims under the 98-02 TransFin policies.

1. Notice of Accidents

Section 3(i), the Notice of Accident provision of Condition 3, allows a claim made after the expiration of the policy period to relate-back to the policy period if (1) KCSR values its liability arising from the Kemp accident at $1 million or more in accordance with Condition 4; (2) notice of the Accident is given to TransFin within 120 days of the valuation; and (3) a Claim is made within 60 months (5 years) of either the date the Claims Agent became aware of the Accident or the expiration date of the Policy, whichever is earlier. Condition 4 establishes the criteria KCSR must use in valuing its liability.

TransFin contends that the three requirements of condition 3(i) were met when (1) on January 16, 2004, Jack Hamer, Director of Claims at KCS, valued the Kemp claims at $1,030,000; (2) on January 28, 2004 Hamer advised Transfin President Ron Russ of the Kemp Accident and its valuation; and (3) the three claims arising from the Accident (Louisiana I, II and Missouri litigations) were filed within five years of the date KCS claim agent Killebrew became aware of the Accident (August 1, 2001). The Reinsurers, however, contend that under 3(i), notice of an Accident must precede the claim to comply with 3(i) and that lawsuits arising from the Kemp Accident were filed on or before notice of the Accident was given. The Reinsurers suggest that the plain meaning of the language from the second paragraph of Condition 3(i) compels this conclusion. Specifically, they contend that a claim preceding notice would not "aris[e] out of" a "*notified* Accident," but rather arise from an Accident not subject to notice. (Doc. 139, at 16) (emphasis added). Transfin, on the other hand, argues that the notice trigger is valuation and that no notice is due until the claims were valued at $1 million or more pursuant to the valuation procedure from Condition 4, regardless of when a claim is made.

The issue is whether, considering the language of subsection 3(i), other provisions in the policy, and the format of the policy itself, an insured must give notice of an Accident before a claim arising from that Accident is made.

The pertinent language from Condition 3(i) is, "[i]f Underwriters receive notification ***in accordance with the above*** they will treat all Claims which ***arise out of the notified Accident***[11] and which are made against the Insured within 60 months . . ." (emphasis added). On its face, the provision contains no express language prohibiting a claim from preceding notice of an Accident. Read with the first paragraph of Condition 3(i), the timing trigger for notice

[11] The policies define "Accident" as "an event which first commences at a specific time after the retroactive date [April 1, 1986] . . . and prior to the expiry date [May 21, 2002, by extension] and of which the Insured's Claim Agent first becomes aware during the Policy Period [June 1, 1998-May 31, 2002]. . . and up to 120 days thereafter."

is Accident valuation. Put another way, notice is not due until the Accident is valued at or more than $1 million. Condition 4 lists four criteria for valuing an Accident, including "the probable or actual jurisdiction, governing law, court and counsel involved in any pending or possible litigation." Read with Condition 3, Condition 4 acknowledges litigation may be pending while an Accident is being valued, before any notice is required. The word "notified" describes an Accident that is noticed according to the first paragraph of 3(i). Claims "arising" from such an Accident, but made after the policy period expiration, are entitled to relate back to the policy period.

The Reinsurers offer a strained interpretation of the policy provisions. Adopting that interpretation would not only rewrite the contract, but would recognize that insureds are in a race to notice an Accident before third parties decide independently to bring suit against the insured. Here, Director of Claims at KCS Rodney Tatum and agent Killebrew concluded after their initial discussions of the Kemp Accident that given the number of eyewitnesses to the accident and other factors that there should be a verdict of no liability for KCSR. (Doc. 150, at Tab 28, Tatum Depo, at

111, 217-18). Nevertheless, KCS set reserves in response to the lawsuits as they were filed.[12] The reserve only reached $1 million in January, 2004 spurred by the Missouri litigation filed in November, 2003. Valuation in January, 2004 and notice to TransFin in the same month demonstrates KCSR complied with Condition 3(i) and 4, and KCSR therefore can avail itself of the relation-back feature in Condition 3.[13]

2. Notice of Claim to TransFin

American Re and Columbia contend that even if KCSR gave proper "Accident Notice," it failed to give proper "Claim Notice" to TransFin pursuant to the subsection two of Condition 3. TransFin, however, argues that although TransFin President William Pinamont did receive immediate notice of the Louisiana claims (copies of the petitions were sent to his attention when they were filed in 2002), that Condition 3(ii) had yet to be triggered because KCSR had not received a written demand for an amount in excess of $1.5

[12] On July 11, 2002, KCS set a $50,000 reserve for the Louisiana I litigation and another $50,000 reserve on September 24, 2002 for the Louisiana II Litigation.

[13] Based on this conclusion, there is no need to address the position that the Reinsurers took in National R.R. Passenger Corp. v. Lexington, No. 01-1815(ESH), 2003 U.S. Dist. LEXIS 26405 (D.D.C. May 20, 2003) and whether judicial estoppel would bar them from making contrary arguments here.

million (50% of its retained self insurance) as of June 29, 2006 (filing date of Reinsurers' summary judgment motions).

Immediate notice to TransFin was accomplished when copies of the Louisiana petitions were sent to TransFin's president. The second paragraph of Condition 3.(ii) describes what assumptions KCSR must make to give adequate claim notice, but here the petitions forwarded to TransFin speak for themselves and put TransFin on notice of the Kemp claims. Where TransFin already had notice of the claims, the date when KCSR assumed liability for the claims based on a demand above $1.5 million or anything else is irrelevant.

III. Notice to Reinsurers

American Re contends that TransFin violated an explicit "prompt" notice provision of the American Re reinsurance certificates. Columbia argues that the notice obligations from the 98-02 TransFin excess policies were incorporated into the lead reinsurance policies so that TransFin owed Columbia notice according to Condition 3. In addition, as a reinsured, TransFin was obliged to give notice to the Reinsurers based on its duty to act with the utmost good faith in a reinsurance relationship. Unigard, 4 F.3d at 1066 (explaining "duty of good faith and fair dealing implied in all contracts also require[s] notice”). TransFin argues that it complied with American Re’s prompt notice provision and while refuting Columbia’s incorporation theory, TransFin argues that it also complied with its implicit duty to give Columbia prompt and full disclosure of the Kemp claims. Moreover, TransFin contends that even if its notice was deemed late under any of the above three theories, the Reinsurers have not suffered substantial prejudice.

Accordingly, the remaining issues are (1) whether TransFin’s notice was late or otherwise inadequate and (2) if notice was late, whether a reinsurer must prove prejudice before it can successfully invoke the defense of late notice by the reinsured, even where a reinsurance policy includes a prompt notice provision.

A. Notice to American Re

American Re contends that TransFin’s May 27, 2004 notice of the Kemp claims was a breach of its prompt notice obligation from Condition 4 of the American Re certificates. American Re argues that TransFin knew or should have known that the Kemp claims could involve American Re reinsurance as early as January, 2003. TransFin contends, on the other hand, that its notice obligation to American Re did not arise until KCSR exhausted its self-insured amount of $3 million, but that it nevertheless gave American Re notice when reserves were just above $1 million.

A threshold issue is whether Condition 4 of the American Re certificates is governed by a subjective or objective standard regarding whether the Kemp claims would involve American Re's reinsurance, an issue no Vermont court has addressed. Courts are divided on interpreting provisions like Condition 4 requiring notice when a claim, "in the opinion of the Company [TransFin] may involve the reinsurance." Compare Christiania Gen Ins. Corp. v. Great American Ins. Co, 979 F.2d 268, 275-76 (2d Cir. 1992) (interpreting such provisions based on objective assessment of information available to an insured who is complying with its duty of due diligence and claims investigation) and Jefferson Ins. Co., v. Fortress Re., Inc., 616 F. Supp. 874, 876, 878 (S.D.N.Y. 1984) (interpreting reinsurance policy language "which appears likely to involve this reinsurance" as implicating objective standard for reinsurer's decision to give notice) with Hatco Corp. v. W.R. Grace & Co., 801 F. Supp. 1334, 1369-70 (D.N.J. 1992) (interpreting excess policy language "in the opinion of [the Company]" as implicating that Company's subjective view). The Second Circuit, however, adheres to the objective standard. See Christiania, 979 F.2d at 275-76. Nevertheless, this Court need not decide whether the Vermont Supreme Court would apply the objective or subjective standard to Condition 4 because under either standard,[14] assuming TransFin's May 27, 2004 notice was not prompt, American Re must show it suffered substantial prejudice from the late notice.

1. Prejudice

In considering the effect of the defense of late notice, the Vermont Supreme Court has held that late notice does "not automatically defeat liability insurance coverage regardless of circumstances," even where a policy makes notice a condition precedent to coverage. Cooperative Fire Ins. Ass'n. v. White Caps, Inc., 166 Vt. 355, 356, 359 (1997). Rather, an insurer may not deny coverage unless "it demonstrates that the notice provision was breached, and

[14] When TransFin knew or should have known that the value of the Kemp claims implicated American Re reinsurance, triggering TransFin's obligation to provide American Re with "prompt notice," is a disputed material fact, making a finding as a matter of law on breach or compliance with Condition 4 inappropriate. Similarly, summary judgment on whether TransFin's claims handling and investigation obligations from Condition 4 also breached TransFin's duty of good faith and fair dealing is inappropriate because that determination also turns on disputed material facts.

that it suffered substantial prejudice from the delay in notice." Id. at 362 (internal citations omitted). While the Vermont Supreme Court has not ruled on whether the notice prejudice rule applies in the reinsurance context, "reinsurance contracts are interpreted according to traditional contract interpretation rules . . . all of which accord with Vermont rules." Professional Consultants, No. 1:03-cv-216, 2006 WL 751244, at *3 (D. Vt. Mar. 6, 2006).[15] In addition, the Second Circuit has addressed the issue, stating that, "[f]or a reinsurer to be relieved from its indemnification obligations because of the reinsured's failure to provide timely notice, absent an express provision in the contract making prompt notice a condition precedent, it must show prejudice resulted from the delay." Christiania, 979 F.2d at 274 (applying New York law). This Court, therefore, finds the Vermont Supreme Court would extend this insurance contract principle to the reinsurance context.

The Second Circuit in Unigard concluded that prejudice

[15] Cases in other jurisdictions apply the rule to reinsurance contracts. See e.g., British Ins. Co. Of Cayman v. Safety Nat. Cas., 332 F.3d 205, 213 (3d Cir. 2003) (holding New Jersey law requires reinsurer to demonstrate prejudice to prevail on late notice defense); Zenith Ins. Co. v. Employers Ins., 141 F.3d 300, 307-308 (7th Cir. 1998) (Wisconsin law); Unigard, 4 F.3d at 1063 (New York law).

must be more than the loss of a right to associate. Unigard, 4 F.3d at 1067, 1069. There, applying New York law, the Second Circuit limited the requisite prejudice to a tangible economic injury. Id. at 1068. The Second Circuit reasoned that "because the reinsurer's and ceding insurer's interests are essentially the same as to liability, good faith coverage decisions generally do not constitute prejudice." Id. The court applied this reasoning even in a "radical case" where the agreement at issue used an "automatic formulae to replace individualized determinations as to the liability of insured and their insurers." Id.

American Re argues in the alternative that TransFin deprived it of a right under the reinsurance certificates, which constitutes prejudice as a matter of law. The Fifth Circuit case cited by American Re at oral argument for this proposition, however, is inapposite for the following reasons. See generally, Motiva Enters., LLC v. St. Paul Fire and Marine Ins. Co., 445 F.3d 381 (5th Cir. 2006). First, Texas law controlled in Motiva and the context was an umbrella insurer rather than a reinsurer. Id. at 383, 385. Second, the prejudice rule that American Re cites from Motiva is not a notice-prejudice rule, but breach of a consent-to-settle clause. In Motiva, the umbrella insurer had a provision in its policy that conditioned settlement coverage on insured obtaining the umbrella insurer's consent. Id. at 383 ("No Insureds will, except at their own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent.") Condition 4 of American Re's reinsurance certificates is, in addition to being a prompt notice provision, a provision that gives American Re an opportunity to associate when so requested. Thus, unlike the umbrella insurer's right to consent for settlement coverage, American Re's right to associate is not compulsory for reinsurance coverage. Third, while Texas appears to have a similar prejudice rule for breach of consent-to-settle provisions as Vermont's notice-prejudice rule, although the Motiva court makes clear that the rule is not settled law, prejudice is different under the rule from prejudice in the Second Circuit. Compare Motiva, 445 F.3d at 386 (holding non-consent, settlement, and lack of opportunity to associate was prejudice as a matter of law) with Unigard, 4 F.3d at 1069 (requisite prejudice for untimely notice limited to economic injury). For the above reasons, Motiva is not applicable here.

Assuming, without deciding, that TransFin's notice was 18 months late, American Re still received notice over two years before the Missouri case was set for trial in August, 2006. Adequate time existed for American Re to associate with TransFin on fact investigation, settlement and/or trial strategy, as provided in Condition 4. Moreover, American Re has not alleged any tangible injury (economic or otherwise) as a result of TransFin's late notice. Any claim that timely notice would have resulted in a lower settlement of the Kemp claims is purely speculative.

2. Bad Faith

American Re argues that it is not required to show prejudice because TransFin's failure to comply with its contractual obligations to investigate claims pursuant to Condition 4 amounted to bad faith. While there is no relevant Vermont case law for a reinsurer's notice-prejudice requirement being relieved with a showing of bad faith, the Second Circuit has held that "a [ceding insurer's] failure to provide prompt notice may entitle the reinsurer to relief without showing prejudice if the [ceding insurer] acted in bad faith." Unigard, 4 F.3d at 1069 (quoting Christiania, 979 F.2d at 281). Simple negligence, however, is not enough to constitute bad faith. Id. Rather, "[t]he proper minimum standard for bad faith should be gross negligence or recklessness." Id. Failing to implement "routine practices and controls to ensure notification to reinsurers" shows the ceding insurer's willful disregard of the risk to reinsurers and is therefore guilty of gross negligence. Id.

American Re misapplied the language "the failure to disclose need not be fraudulent or even intentional" in support of its bad faith argument when the Christiania court used the quoted language in the misrepresentation, rather than notice, context. Christiania, 979 F.2d at 278-80. Similarly, the language, "an innocent failure to disclose a material fact is sufficient" is also in error because the State court used that language to state a general proposition that insolvency is a material fact that must be disclosed in advance to avoid fraud in the inducement of a reinsurance contract, which triggers the right to contract rescission. Mich Nat'l Bank-Oakland v. Am. Centennial Ins. Co. (In re Liquidation of Union Indem. Ins. Co.), 674 N.E.2d 313, 320 (N.Y. 1996). Here, American Re makes no misrepresentation or fraud in the inducement claims and therefore the gross negligence standard for bad faith applies.

Under Unigard's gross negligence standard for bad faith, TransFin's practices and procedures for claims investigation and handling were not, as American Re alleges, gross negligence. Despite TransFin not directly undertaking claims investigation, it did not as American Re alleges, "stick its head in the sand." Rather, TransFin used both KCS' claims department and KCS' insurance broker, Lockton Companies, Inc., for investigation and claims handling of the Kemp claims. Condition 4 requires TransFin to investigate claims, but does not prohibit TransFin from using other claims departments and brokers to effectuate its obligations. Given that TransFin followed a documented claims investigation procedure, TransFin did not fail to implement routine procedures and controls for notifying American Re. Any alleged shortcomings in the TransFin system for claims handling do not rise to the Unigard gross negligence standard for bad faith. Thus, without demonstrating that it has suffered prejudice as a matter of law, American Re may not avoid coverage for late notice.

B. Notice to Columbia

Columbia argues that language in the lead London reinsurance policies incorporates by reference all of the terms and conditions of the 98-02 TransFin policies. From this premise, Columbia argues that TransFin's notice to Columbia was late based on TransFin's obligations under the 98-02 TransFin policies as incorporated into the lead reinsurance policies. Columbia asserts that the following language from Section I. Reinsuring Agreement (located in both lead reinsurance policies) incorporates by reference all of the terms and conditions from the 98-02 TransFin policies:

> It is understood that this Reinsurance covers the legal liability arising out of the Original Insured's operations arising out of Claims first made during the term of this Reinsurance and is ***subject to the same terms and conditions as the original Insurance provided by the Reinsured***, except as where modified by this Reinsurance Agreement. For the purpose of this Reinsurance the Wording attached to this Agreement is deemed to be a copy of the wording within the original Policy document issued to the Original Insured, and in the event of any discrepancy between the actual working within the original Policy document and the Wording attached to this Agreement, it is agreed by the Reinsured and the Reinsurers that the terms and conditions of the Wording attached to this Agreement shall prevail.

(Doc. 150, Tabs 12 and 13) (emphasis added).

Specifically, Columbia argues that the parties intended for Conditions 3 NOTICE OF ACCIDENTS AND CLAIMS and 4

ACCIDENT VALUATION from the 98-02 TransFin policies to be incorporated in their entirety into the reinsurance policy so that the notice and valuation obligations the Insured (KCSR) owed to the Underwriter (TransFin) under Condition 3 would apply equally to TransFin as Reinsured in its reinsurance relationship with the Reinsurers.

Despite couching its argument in terms of Condition 3 of the underlying 98-02 TransFin policies, however, Columbia's contention in essence is that TransFin's notice was late. Therefore, the issue before the Court is assuming, without deciding,[16] that Columbia's theory of incorporation is correct and TransFin's notice was late, whether Columbia suffered the prejudice required under Vermont law to deny coverage.

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[16] The Court is not persuaded that the 98-02 TransFin policies' incorporation into the lead reinsurance contracts shifts the notice obligations of KCSR to TransFin. Rather, the 98-02 policies, as incorporated into the lead reinsurance policies create the scope of coverage reinsured. See Staring, Law of Reinsurance. § 12:5; see also Royal Ins. Co. v. Vanderbilt Ins. Co., 52 S.W. 168, 169 (Tenn. 1899) ("[M]any provisions appropriate to an ordinary agreement with the [insured] could have no proper application to a [reinsurance] contract . . . [and] [w]henever words are found in a contract which can have no proper application to the subject to which it relates they cannot be regarded"). Indeed, some conditions are "local conditions" that pertain only to the underlying insurer and original insured. Faneuil Hall Ins. Co. v. Liverpool & London & Globe Ins. Co., 153 Mass. 63, 69 (1891), 26 N.E. 244. Thus, Conditions 3 and 4 may be considered "local conditions" that pertain only to the relationship between KCSR as insured and TransFin as excess insurer. This finding is consistent with the principle of reinsurance that the reinsurer is in privity with the reinsured and not the original insured and therefore does not assume the same notice of claim and risk assessment functions as the primary insurer. Unigard, 4 F.3d at 1054; Travelers Indemnity Co., 62 F.3d at 76.

It is undisputed that Transfin provided notice to Columbia, at the latest, by email on May 27, 2004.[17] By Columbia's calculation, however, notice was at least eight (8) days late or at most thirty-six (36) days late.[18] The first layer of the lead reinsurance policy is impacted when an amount in excess of $3 million is paid on a given claim, while the second layer is impacted when an amount in excess of $25 million dollars is paid on a claim.

Assuming that notice was late, Columbia must show it suffered prejudice in order to deny coverage for late notice. Columbia, however, argues that the lead reinsurance policies are "claims made"[19] policies to which the Vermont

[17] At the time of notice, TransFin valued the Kemp claims at just above $1 million.

[18] Under Columbia's theory of incorporation, TransFin was obligated to notify Columbia 120 days from the date it valued the Kemp accident at $1 million dollars pursuant to Condition 3(i) and Condition 4. TransFin contends that it valued the Kemp accident at more than $1 million dollars on January 16, 2004, making the 120 day period elapse on May 16, 2004. Counsel for Columbia argued that because TransFin's self-retained insurance under the 2003-04 reinsurance was $10 million, the Kemp accident must have had a value of at least $1.5 million dollars on December 19, 2003 when TransFin gave notice to the 2003-04 reinsurers. Therefore, Columbia suggests the 120 day period should begin on December 19, 2003.

The Court notes that Columbia's argument seems to conflate the 120 day period from valuation of an accident from Condition 3(i) with the requirement from Condition 3(ii) to give claim notice when a claim may deplete accident retention by 50% or more [$1.5 million under the 98-02 reinsurance]. KCSR (TransFin under Columbia's theory) was required to provide claim notice immediately upon valuing the Kemp claims at or above $1.5 million. It is unclear whether TransFin gave accident or claim notice to the '03-04 reinsurers.

[19] "The purpose of claims-made policies, unlike occurrence policies, is to provide exact notice periods that limit liability to a fixed period of time after which an insurer knows it is no longer liable under the policy, and for this reason such reporting requirements are strictly construed." Professional

notice-prejudice rules do not apply. While acknowledging that the Vermont Supreme Court held in Hardwick Recycling & Salvage, Inc., v. Acadia Ins. Co., 177 Vt. 421, 439-40 (2004) that the Cooperative Fire notice-prejudice rule applied to a "claims made" policy, Columbia suggests that the Hardwick court overlooked footnote 2 from Cooperative Fire or was not appropriately briefed on the issue.[20]

This issue, however, can be resolved without relying on or dismissing Hardwick. The lead reinsurance policies here are not even nominally "claims made" policies. Rather they are each entitled "Lloyd's Non-Proportional Reinsurance Policy." Moreover, the fact that the underlying 98-02 TransFin policies are entitled "Excess Railroad Claims Made Liability Policies" does not make the reinsurance policies "claims made" in nature. The underlying TransFin policies specifically put TransFin, as well as the Reinsurers, on notice in the first paragraph of each policy that it may be an atypical claims made policy by stating:

THIS IS AN EXCESS LIABILITY CLAIMS MADE POLICY WHICH IS

Consultants, No. 1:03-cv-216, 2006 WL 751244, at *8 (D. Vt. Mar. 6, 2006) (internal citations omitted).

[20] Footnote 2 provides: "We are not presented here with the question of whether the rule should be different when the case involves a "claims made" policy, as some courts have held, and therefore express no opinion on the subject." Cooperative Fire, 166 Vt. at 363 n. 2.

> NOT SUBJECT TO THE TERMS AND CONDITIONS OF ANY OTHER INSURANCE AND CONTAINS PROVISIONS WHICH MAY BE DIFFERENT FROM THOSE OF ANY OTHER INSURANCE.
>
> (Doc. 150, at TAB 12, p. 723).

Moreover, there are several varieties of "claims made" policies that deviate from the less common pure "claims made" policies. National R.R. Passenger Corp., v. Lexington Ins. Co., No. 01-1815 (ESH), 2003 U.S. Dist. LEXIS 26405, at 18-19 (D.D.C. May 20, 2003). The 98-02 Transfin policies must be considered hybrid "claims made" policies by virtue of Condition 3, which provides that claims made after the expiration of the policies may be deemed made during the policy if the insured gives timely notice to the insurer. Id. at *24 (finding identical Condition 3(i) causes policy nominally titled "claims made" to fall outside the definition of pure claims made policy). The notice period requirements of "claims made" policies, therefore, do not control either the reinsurance policies or the underlying 98-02 Transfin policies. Thus, the limitation set forth in footnote 2 of Cooperative Fire does not impact the lead reinsurance policies, and the issue remains whether the Vermont Supreme Court would extend the notice-prejudice rule to reinsurance. As stated supra, this Court believes it would.

Here, Columbia has not shown substantial prejudice. It contends that had it received timely notice of the catastrophic injuries as the Louisiana claims were being filed, and if the claims could have been disposed of well below TransFin's self-insured and accident retention amount ($3 million), it would have insisted the Kemp claims be promptly resolved. (Doc. 193, at 8). Columbia also argues that learning of the Kemp accident three (3) years after it occurred, and two years after the reinsurance expired amounts to substantial prejudice. Unless provided for specifically in the reinsurance agreement, which was not done here, reinsurers must rely on the ceding insurer and on the industry custom of utmost good faith when it comes to claims investigation, setting reserves and claims defense. See Unigard, 4 F.3d at 1054. Columbia was notified, given full disclosure and access to KCS's claims files, and invited to associate in the claims defense. To that end, on July 13, 2004, the London reinsurers hired an attorney to represent them and the lead reinsurance policies (upon which the Columbia certificates are based) in the Kemp claim. Finally, two years remained before the first Kemp trial was set to begin. As with American Re, Columbia's assertion that earlier notice would have reduced the amount of the Kemp settlement is speculative. Accordingly, having failed to show substantial prejudice, Columbia's late notice coverage defense is denied.

IV. Punitive Damages

American Re contends that punitive damages assessed against KCSR are excluded from coverage under the 98-02 policies and therefore not part of American Re's obligation to indemnify TransFin under the American Re certificates of reinsurance. (Doc. 225-1). The December 2006 settlement of the Kemp Claims for $37.5 million triggered American Re's obligation to indemnify TransFin pursuant to Condition 1 of the American-Re reinsurance certificates. The issue is whether the settlement was at least arguably within the insurance coverage American Re agreed to reinsure. If this Court can determined that the settlement included punitive damages, American Re seeks to amend and/or supplement its pleadings to allocate the amount of the settlement between covered and uncovered (punitive damage) claims. (Doc. 225-1).

A post-settlement denial from a reinsurer, raises the "follow the fortunes" doctrine, which TransFin argues prohibits American Re from second-guessing its "good faith liability determinations" in choosing to settle the Kemp claims. Christiania, 979 F.2d at 280. Condition 1 of the American Re certificates could be considered a "follow the fortunes" provision because it bases American Re's indemnification obligation on the TransFin's underlying policies' coverage. Even if the American Re certificates contain no explicit "follow the fortunes" clause, the doctrine is implied in the reinsurance industry. Aetna Cas. and Sur. Co. v. Home Ins. Co., 882 F. Supp. 1328, 1350 (S.D.N.Y. 1995).

The "follow the fortunes" doctrine requires a reinsurer to indemnify the ceding insurer for payments reasonably within the terms of the original policy, even if technically not covered by it. Christiania Gen. Ins., 979 F.2d at 280. "While the reinsurer is not required to pay for losses that are not covered under the underlying policy, 'a reinsurer cannot second guess the good faith liability determinations made by its reinsured, or the reinsured's good faith decision to settle a claim.'" Nat'l Union Fire Ins. v. American Re-Ins., 441 F. Supp. 2d 646, 650 (S.D.N.Y. 2006) (quoting Christiania, 979 F.2d at 280). The Second Circuit has held that the "follow the fortunes" doctrine "simply requires payment where the cedent's good-faith payment is at least arguably within the scope of the insurance coverage that was reinsured." Mentor Ins. Co. (U.K.) v. Norges Brannkasse, 996 F.2d 506, 517 (2d Cir. 1993). The standard for coverage by the reinsurer "is purposefully low and the decision making process of the ceding insurer is not subject to de novo review." Nat'l Union Fire Ins., 441 F. Supp. 2d at 651. Thus, the reinsurer must follow the fortunes unless the cedent paid a settlement that was "clearly or manifestly outside the scope of the reinsured's policy coverage." Id.

American Re contends that punitive damages against KCSR for all but vicarious liability are excluded in Endorsement 3 of the 98-02 TransFin policies and because the Missouri claimants sought to hold KCSR directly liable for punitive damages, part of the settlement necessarily included punitive damages. TransFin disputes American Re's interpretation of Endorsement 3 and contends that the 98-02 policies provide coverage for punitive damages. Neither side alleges that the terms of the 98-02 TransFin policies relevant to punitive damages are ambiguous. Nevertheless, because the Court can resolve the issue based on the "follow the fortunes" doctrine, it need not interpret the disputed endorsements.

As noted above, to be rejected, the settlement must be clearly outside the scope of the reinsured policy coverage. In addition, there is an "inherent tension between the 'follow the fortune' clause[] and limitations on the liability of reinsurers." American Ins. Co. v. North American Co. for Prop. and Cas. Ins., 697 F.2d 79, 81 (2d Cir. 1982). In National Union Fire, for example, the excess insurer allocated claims of twenty-one plaintiffs evenly between two different policies, but in doing so, exceeded the policy maximum for one of the policies. Nat'l Union Fire Ins., 441 F. Supp. 2d at 649. When the reinsured attempted to collect from its reinsurer, payment was refused based on an exclusion clause in the reinsurance policy. Id. at 650. The court reasoned that the method of payment was "at least arguably within the scope of the insurance that was reinsured" and therefore "decline[d] 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."

Id. at 652. On the other hand, the Second Circuit refused to hold a reinsurer liable for a settlement that was clearly designed to compensate the insured for a punitive damage award where the underlying policy limited coverage for punitive damages to vicarious liability. American Ins. Co., 697 F.2d at 81. In American Insurance Co., the district court allowed extrinsic evidence to resolve ambiguity concerning the meaning of the term "damages." Id. Based on the extrinsic evidence, it was determined that coverage for punitive damages only extended to the vicarious liability of the insured. Id. The reinsured settled for $500,000 while a jury award of $146,970 in compensatory damages and $750,000 in punitive damages was on appeal. Id. at 80. The reinsurer refused coverage under the same argument American Re asserts here: the underlying insurance policy, and therefore the reinsurance agreement did not cover punitive damages assessed for intentional misconduct. Id. In affirming the trial court, the Second Circuit noted that it was "clear that the settlement . . . was primarily designed to compensate [insured] for a punitive damage award that is excluded from the reinsurance policy." Id. at 81.

Here, even assuming, as American Re contends, that TransFin's 98-02 policies only provide coverage for punitive damages stemming from vicarious liability, it is not clear that American Re's $8.2 million share of the $37.5 million settlement would compensate KCSR for more than the undisputedly insured (compensatory) risks. Unlike American Insurance Co., where a jury verdict allocated a hugely disproportionate percentage of damages to punitive damages ($750,000 compared with $146,970) and the reinsured sought half of the $500,000 settlement from the reinsurer, here there was no judgment indicating that the Missouri claimants would prevail and if so, what amount, if any, would be awarded in punitive damages. It is not clear whether any of the settlement included punitive damages; and this Court refuses to speculate on whether punitive damages would have been awarded had the case proceeded to judgment. This Court also declines American Re's invitation to re-open a settlement, which was within TransFin's policy limits of $47 million, to determine what, if any, portion of American Re's share is attributable to punitive damages. There is no allegation that the settlement was not in good faith and, without more, no evidence of punitive damages being a part of the settlement, which does not put the Kemp settlement clearly outside of the risks American Re agreed to reinsure. See Christiania, 979 F.2d at 280 (doctrine requires indemnification for payments reasonably within terms of original policy, even if technically not covered by it); Nat'l Union Fire Ins., 441 F. Supp. 2d at 652 (declining to inquire into cedent's settlement if it was in good faith, reasonable and within terms of the policies). Accordingly, American Re's motion to amend the pleadings is denied.

V. Motions to Strike (Docs. 180, 206)

Although only Columbia and American Re remain, all Reinsurers joined in a motion to strike the Anthony McCarthy affidavit pursuant to Fed. Civ. Pro. R. 56(e) because his statements were not made from his personal knowledge. (Doc. 180). The disputed statements relate to whether the parties intended concurrency between the 98-02 Transfin policies and the reinsurance policies. Because the Court was able to resolve the notice to Columbia issue without reaching the issues of incorporation and whether extrinsic evidence of the parties' intent to incorporate certain terms would be admissible, the motion to strike is moot.

American Re also moved to strike Art Carmody's post-deposition affidavit, arguing it is inconsistent with, and contradicts his deposition testimony on outcome-determinative issues. (Doc. 206). Specifically, American Re contends that Carmody's affidavit impacts the Condition

3(ii), Notice of Claim and the Condition 4, Notice to American Re provisions in the 98-02 TransFin policies and the American Re reinsurance certificates respectively. Given the Court's findings supra, however, the Carmody affidavit was not outcome-determinative on either issue. First, the timing of when KCS knew a claim may exceed $1.5 million, triggering its obligation to notify TransFin, is irrelevant because TransFin's president was on notice of the Kemp petitions as they were filed. Second, the Court assumed late notice in deciding American Re had not shown the substantial prejudice required under Vermont law to deny coverage, without relying on the Carmody affidavit.

CONCLUSION

For the foregoing reasons, Columbia's motion is DENIED, American Re's motion is DENIED, TransFin's motion is GRANTED, American Re's motion to file supplemental pleadings is DENIED, and the motions to strike are DENIED.

Dated at Burlington, in the District of Vermont, this 27th day of April, 2007.

/s/ Jerome J. Niedermeier

Jerome J. Niedermeier
United States Magistrate Judge