UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PENNSYLVANIA Plaintiff, v. CLEARWATER INSURANCE COMPANY, Defendant.	MEMORANDUM & ORDER 04-CV-5032

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OWEN, District Judge:

Before me are plaintiff's Motion for Summary Judgment, and defendant's Motion to Compel discovery.

This is a dispute over a reinsurance bill, wherein a reinsurer agrees to reinsure a portion of another insurer's risks. Insurer-plaintiff National Union Fire Insurance Company of Pittsburgh ("NU") paid reinsurer-defendant Clearwater Insurance Company ("Clearwater") to assume a portion of NU's potential exposure under two excess liability insurance policies issued to Minnesota Mining and Manufacturing Company ("3M"), one in 1979, and one in 1980.

In the early 1990s, 3M faced massive exposure from its manufacture and sale of breast implants. 3M sought insurance coverage from its numerous insurance carriers, who either denied coverage or reserved their rights, leading to insurance coverage litigation in Minnesota state court. 3M sought both defense and indemnity under its insurance policies, as well as claims arising out of AIG's conduct (NU is a subsidiary of AIG). Specifically, 3M claimed consequential damages, alleging that it lost profits as a result of the insurers' bad faith failure to pay its defense and indemnity costs under the policies (the "consequential damages claims").[1]

[1] These claims of 3M against NU are referred to as "ancillary claims" and "extra-contractual claims" in the parties' papers.

The insurance coverage trial had two phases; phase one addressed defenses asserted by the various carriers, and phase two addressed 3M's consequential damages claims. Phase one proceeded to a verdict, which was sealed so the parties did not know the result. This is not before me. In phase two, 3M sought $70-80 million in consequential damages claims against the AIG Companies, including NU. During phase two, NU settled with 3M, paying $197 million dollars to resolve the pending insurance coverage litigation, and to be released from liability for all paid, pending, and unasserted breast implant claims. NU billed Clearwater for a total of $1,958,030.97, and Clearwater made two payments totaling $500,000. NU then filed this breach of contract action to recover $1,458,030.97, plus interest.

The two NU policies "follow all the terms and conditions of" a policy that Lakeside Insurance Limited had previously issued to 3M, which indemnified 3M "for all sums which the insured shall become legally obligated to pay as damages because of injury or damage to which this policy applies."[2]

The relevant general conditions of the related reinsurance certificates are three.

> General Condition 1: Clearwater's liability under this Certificate shall follow NU's liability in accordance with the terms and conditions of the policy reinsured hereunder.
>
> General Condition 3(c): Upon receipt by Clearwater of satisfactory evidence of payment of a loss for which reinsurance is provided hereunder, Clearwater shall promptly reimburse NU for its share of the loss.
>
> General Condition 3(d): The term "loss" shall mean only such amounts as are actually paid by NU in settlement of claims.

[2] Cohen Ex. G at ODY 275.

I turn first to plaintiff NU's Motion for Summary Judgment. Summary judgment should be granted when "there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). NU submits that the contract is clear and that Clearwater is liable under the contract for their portion of the full settlement amount, because it was paid "in settlement of claims," under General Condition 3(d). Clearwater agrees that the contract is clear, but submits that it is not liable for any consequential damages claims 3M asserted against NU, because pursuant to General Condition 3(c), Clearwater is only to reimburse NU upon receipt of "satisfactory evidence of payment of a loss *for which reinsurance is provided* hereunder" (emphasis supplied) and that some portion of the settlement payment is to settle the consequential damages claims not covered by the certificates.

As an initial matter, Clearwater's position is correct. However, NU has asserted the follow-the-fortunes doctrine, which requires the reinsurer to pay its reinsured "where the cedent's good-faith payment is at least arguably within the scope of the insurance coverage reinsured," Mentor Ins. Co. (U.K.) v. Brannkasse, 996 F.2d 506, 517 (2d Cir. 1993), and that the reinsurer may not "second guess the good faith liability determinations made by its reinsured." Christiana Gen. Ins. Corp. v. Great American Ins. Co., 979 F.2d 268, 280 (2d Cir. 1992). Clearwater counters that the follow-the-fortunes doctrine does not apply because the settlement payment included payments for claims that were not actually covered by the policies, specifically the consequential damages claims asserted by 3M against AIG. See American Ins. Co. v. North American Co. for Property & Cas. Ins., 697 F.2d 79, 81 (2d Cir. 1982). In support of its position, Clearwater has submitted a redacted copy[3] of February 8, 2000 letter from the Mound, Cotton & Wollan law firm to AIG regarding settlement with 3M.[4] The letter advises AIG that 3M was seeking consequential damages "arising out of

[3] NU has submitted an unredacted copy of the letter for *in camera* review which I have also reviewed.
[4] Lenci Dec. Ex. 5.

insurers' failure to make timely payments."[5] In addition, Clearwater has submitted a memorandum from AIG's trial counsel in the coverage litigation, Simpson, Thacher & Bartlett, that focuses on the possibility of exposure to "extra-contractual consequential damage claims that 3M alleges exceed $1 billion."[6]

The follow-the-fortunes doctrine both promotes settlement, and reduces litigation by "preventing a reinsurer from continually challenging the propriety of a reinsured's settlement decision." Traveler's Cas. and Surety Co. v. Certain Underwriters at Lloyd's of London, 96 N.Y. 2d 583, 596 (2001). This case demonstrates the "inherent tension between 'follow the fortune' clauses and limitations on the liability of reinsureres." American Ins. Co. v. North American Co. for Property & Cas. Ins., 697 F.2d 79, 81 (2d Cir. 1982). Clearwater has provided sufficient evidence to satisfy me that a genuine issue of material fact exists as to whether the settlement did indeed involve payment in some substantial amount of the consequential damages claims, including the Mound, Cotton & Wollan letter, the Simpson, Thacher & Bartlett memo, and the fact that the settlement occurred during the phase of the trial of the consequential damages claim. Accordingly, valid issues of fact exist and plaintiff's Motion for Summary Judgment is denied.

Next, Clearwater seeks compelled production of 1) any unproduced emails between NU and its trial counsel, Simpson, Thacher & Bartlett, regarding settlement negotiations; 2) communications with other reinsurers regarding the settlement; and 3) an unredacted copy of the Mound, Cotton & Wollan letter. Under the Federal rules, discovery is permitted as to "any matter, not privileged, that is relevant to the claim or defense of any party." Fed. R. Civ. P. 26(b)(1).

First, I turn to the unproduced emails between NU and their trial counsel, Simpson, Thacher & Bartlett, regarding settlement negotiations. NU has produced the emails, save any that may possibly exist on 113 back-up tapes for September 15 – 21, 2000, and from December 21 – 30,

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[5] Id.
[6] Lenci Dec. Ex. 2 at ODY 17.

2001.[7] NU estimates that the cost to restore the data on the back-up tapes is between $400 and $700 per tape, for a total between $45,200 and $79,100, plus attorney's time in reviewing the documents. Under Rule 26(b)(2) of the Federal Rules of Civil Procedure, the Court has the power to limit discovery if "the burden or expense of the proposed discovery outweighs its likely benefit."[8] Defendant has not sufficiently demonstrated that responsive emails exist on the back-up tapes,[9] which are for time periods of seven months and twenty-two months *after* the settlement was reached. I conclude that the expense of the proposed discovery outweighs its likely benefit, and I decline to compel NU to restore the emails from the back-up tapes. [10]

Second, I turn to communications between NU and other reinsurers concerning the "3M Cases, the 3M Settlement, the Settlement Amount, or the same loss..." Clearwater submits that such communications are relevant to the extent that they show NU actually did make extra-contractual payments toward the consequential damages claims.[11] NU contends that such communications are not relevant to Clearwater's indemnity obligations. While NU's communications with other reinsurers concerning the "3M Cases" generally is overbroad, and that part of the request is hereby stricken, the remains of the request, communications with other reinsurers concerning the "3M Settlement, the Settlement Amount or the same loss" could, however, lead to relevant documents, and I hereby order their production.

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[7] Pursuant to its email retention policy of keeping its back-up tapes for two weeks, AIG (NU's parent company) does not currently have emails from the relevant period; it has, however, found that back up tapes for September 15 – 21, 2000, and from December 21 – 30, 2001 still exist, and were for some reason not reused (thus deleting the backed up emails). Simpson, Thacher & Bartlett automatically deletes emails within two or three weeks, and no longer has any emails on computers from the relevant period.

[8] Factors to consider are "the needs of the case, the amount in controversy, the parties' resources, the importance of the issues at stake in the litigation, and the importance of the proposed discovery in resolving the issues."

[9] Relatively few emails have been produced overall; Clearwater's production includes only five emails, Simpson Thacher Bartlett's correspondence file contained only five emails (but many memoranda and letters), and NU's original production contained only fifteen pages of email.

[10] As it stands, if Clearwater wishes to pay to restore the data of the back-up tapes, it may do so.

[11] NU contends that other reinsurers may have had policies that had ECO clauses, which would have covered extra-contractual obligations, and that NU may have disclosed to them that the settlement payment did indeed encompass the consequential damages claims.

Third, I turn to the request to compel the unredacted portion of the Mound, Cotton & Wollan letter. Clearwater submits that the letter contains advice rendered in the ordinary course of NU's business, and is thus unprivileged. In the alternative, Clearwater submits that even if the letter is privileged, it should be produced in its entirety under the "fairness doctrine."[12] Clearwater's arguments both fail. The letter is protected by the attorney client privilege, as NU was evaluating whether to settle with 3M, and Mound, Cotton & Wollan was rendering legal advice on the consequences of a settlement. As to the "fairness doctrine" argument, that doctrine "aims to prevent prejudice to a party and distortion of the judicial process that may be caused by the privilege-holder's selective disclosure..."[13] Having seen the redacted and unredacted versions of the letter, I find that there has been no prejudice or distortion of the judicial process warranting production of the entire letter, and I therefore decline to compel its production.

Accordingly, plaintiff's Motion for Summary Judgment is denied, and defendants Motion to Compel is granted in part and denied in part.

So ordered.

Dated: New York, New York
July 21, 2007

UNITED STATES DISTRICT JUDGE

[12] American Steamship Owners Mutual Protection and Indemnity Assoc., Inc. v. Alcoa Steamship Co., Inc. 232 F.R.D. 191 (S.D.N.Y. 2005).
[13] Id. at 199