PRESENTATIONS

The Cobbler's Children Have No Shoes:

What Insurance Coverage Attorneys Need to Know About their Professional Liability Insurance Policies

2017 Annual Meeting
May 11-12, 2017
Chicago, IL

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What Constitutes a Claim?

- Is the term "claim" defined in the policy? If not, how do you determine whether a claim has been made?
- If the term "claim" is defined in the policy as a demand for money or services, how do you determine if the letter you receive from a potential claimant qualifies as a demand for money or services?
- Is a request for your insurance information or records without more a claim?
- To report or not. What happens if you conclude that a claim has not been made and the insurer concludes otherwise?

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What are "Professional Services"?

Courts' descriptions:

- Arises from "a vocation, calling, occupation, or employment involving specialized knowledge, labor, or skill"
- "Predominantly mental or intellectual"
- "Evidenced by the need for specialized learning or training" and distinguishable from "the ordinary activities of life and business"

Frequently debated issues:

- Fee disputes
- Business pursuits with clients

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The Related Acts Exclusion

Badges of relatedness:

- Same or different parties
- Same or different time periods involved
- Similar or different alleged wrongful acts
- Same or different duties, and if the same, are the people or entities to whom the duties were owed the same or different
- Same or different causes of action, and if different, do the causes of action arise out of the same core of operative facts
- Same or different damages or remedies sought

Recent application of test: *National Union Fire Ins. Co. v. Zillow, Inc.,* No: C16-1461JLR (W.D. Wash. April 13, 2017) (finding in trademark dispute that demand letter requesting removal of photographs from Zillow website before policy incepted to be related to later lawsuit)

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Prior Knowledge Provisions and Related Acts Provision

Each wrongful act, in a series of wrongful acts, will be deemed to have occurred on the date of the first wrongful act.

- *OneBeacon Ins. Co. v. T. Wade Welch & Assocs*., 2012 WL 6608264 (S.D. Tex. Dec. 18, 2012) *aff'd* 841 F. 3d 669 (5th Cir. 2014)

  Court held that a related acts provision together with prior knowledge provision is ambiguous as applied to facts of that claim.

- Litigating prior knowledge and related acts can be difficult – developing a complete record is critical

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What Is The Prior Knowledge Provision?

The policy only provides coverage when **no insured** had a basis to believe that any such act or omission or interrelated act or omission might reasonably be expected to give rise to a claim

If any insured had a basis to believe an act or omission might lead to a claim, there is no coverage.

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Prior Knowledge – Sample Policy Provision

This Policy does not apply to and We shall have no obligation to pay any Damages, Claim Expenses or Supplemental Payments for any Claim:

D. based upon or arising out of any actual or alleged Wrongful Act that:

***

3. You had knowledge of prior to the Policy Period and had a reasonable basis to believe that such Wrongful Act could give rise to a Claim; provided, however, that if this Policy is a renewal or replacement of a previous policy issued by Us providing materially identical coverage, the Policy Period referred to in this paragraph will be deemed to refer to the inception date of the first such policy issued by Us.

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Prior Knowledge Provisions

- *Truck Ins. Exch. v. Ashland Oil, Inc.*, 951 F.2d 787 (7th Cir. 1992); *Bryan Bros., Inc. v. Cont'l Cas. Co.*, 660 F.3d 827 (4th Cir. 2011).
- *Foster v. Winchester Fire Ins. Co.*, No. 09-1459, 2012 U.S. Dist. LEXIS 88274 (W.D. Pa. June 26, 2012)

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Knowledge - Objective or Subjective?

- Courts have held that a mixed subjective/objective analysis applies. There must be actual subjective knowledge of the facts related to the act or omission. And the objective component must be met – a reasonable professional in the insured's position would expect it to give rise to a claim. *Cohen-Esrey Real Estate Services, Inc. v. Twin City Fire Ins. Co. and Hartford Fire Ins. Co.,* 636 F.3d 1300 (10th Cir. 2011)
- A subjective test applies only to the "knowledge" aspect of the application question, while an objective test applies to the "might reasonably be expected to give rise to a claim" component. *Perkins v. Am. Int'l Specialty Lines Ins. Co.*, No. 1:12-cv-3001-TWT, 2012 U.S. Dist. LEXIS 175592 (N.D. Ga. Dec. 11, 2012)

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Evaluating the Insured's Knowledge - Extrinsic Evidence Considered

- *Westport Ins. Co. v. Albert*, 208 F. App'x 222 (4th Cir. 2006) (prior pleadings in a related matter established knowledge)
- *American Guarantee & Liability Ins. Co. v. Fojanini*, 90 F. Supp. 2d 615 (E.D. Pa. 2000) (correspondence predating lawsuit established knowledge)
- *Eisenhandler v. Twin City Fire Ins. Co.*, 2011 WL 5458180 (Conn. 2011) (extrinsic evidence relevant to whether insured knew his client would sue him considered)

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Evaluating the Insured's Knowledge - Extrinsic Evidence Not Considered

- *M.D. Sass Investors Servs., Inc. v. Reliance Ins. Co.,* 810 F. Supp. 1082 (N.D. Cal. 1992) (court refused to consider extrinsic evidence because prior knowledge provision was an exclusion)
- *Am. Guar. & Liab. Ins. Co. v. Hoeffner*, 2009 WL 130221 (S.D. Tex. 2009) (court held duty to defend applied because underlying suit did not allege prior knowledge of facts)
- *Home Mut. Ins. Co. v. Lapi*, 596 N.Y. F.2d 885 (N.Y. App. Div. 1993) *Or. Ins. Guar. Assn. v. Thompson*, 760 P.2d 890 (Or. Ct. App. 1988) (court considered extrinsic evidence where insured admitted intentional conduct but the underlying suit alleges negligence)

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Failure to Disclose/Misrepresentation in Application for Insurance

A standard application provision reads:

It is understood and agreed that failure to provide true and complete response to any of the questions, statements or request for information in this Application or to provide any other information material to this Application may, at the sole option of the insurer, result in the voiding of the insurance policy issued in reliance on this Application and /or denial of coverage for specific claims asserted against us (the Applicant) or any other insured under the policy. The undersigned on behalf of the Applicant and all other insureds under this policy issued by the insurer, hereby waives any defense to an action by the insurer for voiding or revoking of the policy based upon misrepresentation of fact or failure to disclose material information in connection with this Application. The Applicant agrees to hold the insurer harmless from all loss as a result of any such misrepresentation or failure to disclose, including, without limitation, all costs and attorney fees incurred by the insurer in connection with said action for voiding or revoking the policy.

I HEREBY DECLARE that the above statements and particulars are true to the best of my knowledge, that I have not suppressed or misstated any facts and I agree that this application shall form part of the insurance policy. I also acknowledge that I am obligated to report any changes that could affect the disclosures in this application that occur after the date of signature, but prior to the effective date of coverage.

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Failure to Disclose/Misrepresentation in Application

- *Perkins v. Am. Int'l Specialty Lines Ins. Co.,* No. 1:12-cv-3001-TWT, 2012 U.S. Dist. LEXIS 175592 (N.D. Ga. Dec. 11, 2012)

  Failure to disclose circumstances of a claim is material information.

- *Goodman v. Medmarc Ins*., 977 N.E.2d 128 (Ohio Ct. App. 2012)

  Misrepresentation was a representation, not a warranty, and does not void the policy.

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Failure to Disclose/Misrepresentation in Application

- Rescission actions vary by state law
- Standard is typically more onerous than prior knowledge coverage defense
- Fully developed record is important

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Personal Profit Exclusion

Limits coverage for "any Claim based on, or arising out of, or in any way involving any Insured having gained any personal profit or advantage to which he or she was not legally entitled." Berkley Ins. Co. Lawyers Professional Liability Policy, LPL 39450 (10-14) at IV.K.

Application of exclusions requiring:

- Wrongful profit or advantage
- Profit "in fact"

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Questions?

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WAR AND PEACE (THE ABRIDGED VERSION): APPLICATION OF THE WAR AND TERRORISM EXCLUSIONS

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Bruce D. Celebrezze and Elizabeth J. Stewart

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The Beginning of War Exclusions

Civil War: extra premiums charged based on proximity to war zone

Civil War: 1861-1865

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The Beginning of War Exclusions

WWI: Brought into existence the modern types of war exclusions.

World War I: 1914 - 1918

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ISO Coverage Form: War Exclusion

2. Exclusions

This insurance does not apply to:

* * *

i. War

"Bodily injury" or "property damage," however caused, arising, directly or indirectly, out of:

1. war, including undeclared or civil war;
2. warlike action by a military force, including action in hindering or defending against an actual or expected attack, by any government, sovereign or other authority using military personnel or other agents; or
3. insurrection, rebellion, revolution, usurped power, or action taken by governmental authority in hindering or defending against any of these.

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What Constitutes a "War"?

- U.S. Const. art. I, § 8, cl. 11: Congress has the sole power to declare war.
- U.S. Const. art. II, § 2: names the President Commander-in-Chief of the armed forces; bestows the President with the power to direct the military after a Congressional declaration of war.

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Congressional Declarations of War

- Congress has only declared war on 5 occasions against 11 countries
  - War of 1812: Great Britain
  - Mexican-American War: Mexico
  - Spanish-American War: Spain
  - WWI: Germany, Austria-Hungary
  - WWII: Japan, Germany, Italy, Bulgaria, Hungary, Romania

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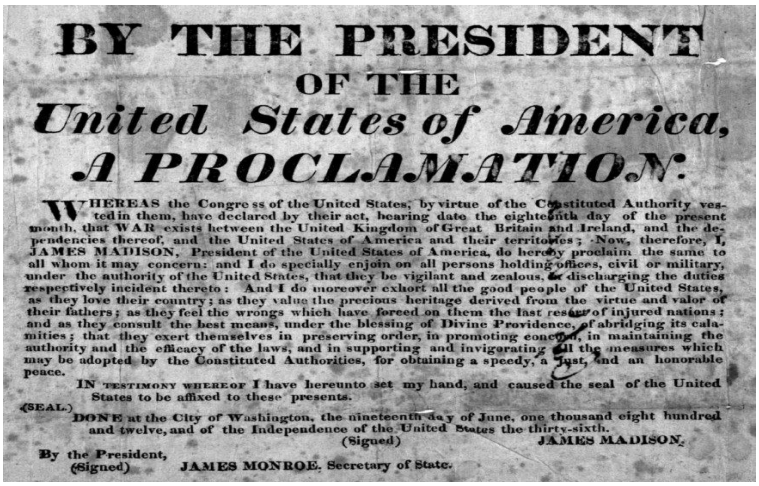
Congressional Declarations of War



BY THE PRESIDENT
OF THE
United States of America,
A PROCLAMATION.

WHEREAS the Congress of the United States, by virtue of the Constituted Authority vested in them, have declared by their act, bearing date the eighteenth day of the present month, that WAR exists between the United Kingdom of Great Britain and Ireland, and the dependencies thereof, and the United States of America and their territories; Now, therefore, I, JAMES MADISON, President of the United States of America, do hereby proclaim the same to all whom it may concern: and I do specially enjoin on all persons holding offices, civil or military, under the authority of the United States, that they be vigilant and zealous, in discharging the duties respectively incident thereto: And I do moreover exhort all the good people of the United States, as they love their country; as they value the precious heritage derived from the virtue and valor of their fathers; as they feel the wrongs which have forced on them the last resort of injured nations; and as they consult the best means, under the blessing of Divine Providence, of abridging its calamities; that they exert themselves in preserving order, in promoting concord, in maintaining the authority and the efficacy of the laws, and in supporting and invigorating all the measures which may be adopted by the Constituted Authorities, for obtaining a speedy, a just, and an honorable peace.

IN TESTIMONY WHEREOF I have hereunto set my hand, and caused the seal of the United States to be affixed to these presents.

(SEAL.)

DONE at the City of Washington, the nineteenth day of June, one thousand eight hundred and twelve, and of the Independence of the United States the thirty-sixth.

(Signed) JAMES MADISON.

By the President,
(Signed) JAMES MONROE, Secretary of State.

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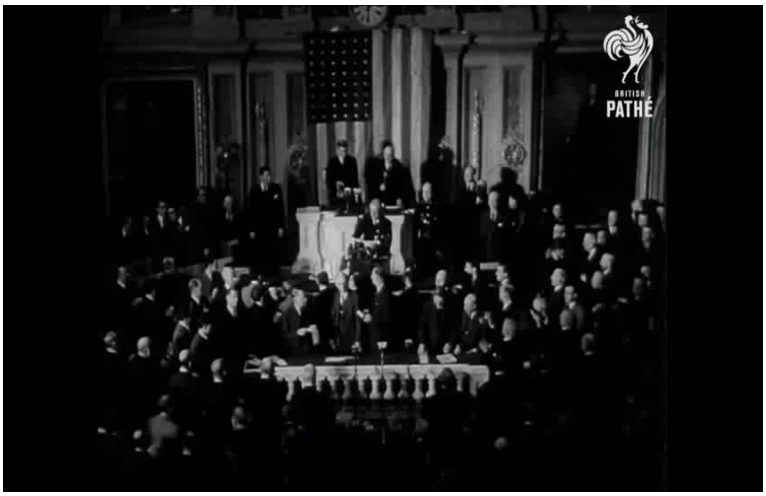
FDR Declares War on Japan



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Bas v. Tingy, 4 U.S. 37 (1800)

- One of the earliest cases to address what constitutes a "war."
- Held the naval conflict with France from 1798 to 1800 constituted a "war."
- Conflict was an "external contention by force, between some of the members of the two nations, authorized by the legitimate powers."

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Expansion of What Constitutes a War

Courts have found the following to constitute a war:

- **Blockade**: *The Amy Warwick,* 67 U.S. 635, 670 (1862)
- **Rebellion**: *Dole v. Merchants' Mut. Marine Ins. Co.,* 51 Me. 465 (1863)
- **Conflict between US and Native American tribe**: *Montoya v. United States,* 180 U.S. 261, 270 (1901)
- **Offensive Entry** (i.e., Kuwait, Afghanistan, Iraq): *Dellums v. Bush*, 752 F.Supp. 1141, 1146 (D.D.C. 1990)

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Interpreting the Meaning of "War"

Three Doctrines: Developed during WWII

1. Technical Meaning
2. Common Meaning
3. Inherently Ambiguous

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Is the Loss Covered?

Ambiguous Scenarios:

1. Loss occurs prior to the formal declaration of war;
2. Loss occurs after the cessation of hostilities, but prior to the official termination of the war;
3. Loss occurs in hostilities that are never formalized by a declaration of war; and
4. Loss occurs after the cessation of hostilities that were never formalized by a declaration of war.

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Korean War / Suez War

- After the Korean War, courts began adopting common meaning doctrine as chosen method of interpretation.
- *Shneiderman v. Metro. Cas. Co. of N.Y.,* 14 A.D.2d 284 (N.Y. 1961) (Suez War conflict constituted a war under the exclusionary clause, but held that the beneficiary was entitled to benefits because the journalist died four days after the warring nations had agreed to a cease fire).

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Vietnam War

Expansion of the Definition of "War" in the Policy

- Undeclared war
- Warlike Conditions
- Warlike Operations

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ISO Coverage Form: War Exclusion

2. Exclusions

This insurance does not apply to:

* * *

i. War

"Bodily injury" or "property damage," however caused, arising, directly or indirectly, out of:

1. war, including undeclared or civil war;
2. warlike action by a military force, including action in hindering or defending against an actual or expected attack, by any government, sovereign or other authority using military personnel or other agents; or
3. insurrection, rebellion, revolution, usurped power, or action taken by governmental authority in hindering or defending against any of these.

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Earlier Case Law on Terrorism Incidents

- *Pan American World Airways v. Aetna Casualty and Surety Co.,* 505 F.2d 989 (2d Cir. 1974).
- PFLP hijacks aircrafts over London; destroyed in Egypt in 1970.
- Pan American sought coverage from its various underwriters under its all-risk policies.

Pan American Aircraft Hijacked and Bombed

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Pan American World Airways v. Aetna Casualty and Surety Co., 505 F.2d 989 (2d Cir. 1974)

- Second Circuit rejects insurers' reliance upon the war exclusion. Rationale:
  - PFLP not recognized by any nation state.
  - PFLP were agents of a radical political group, not a sovereign government.
  - PFLP receiving financial support from several states does not give it the status of "quasi-sovereign."
  - PFLP's own rhetoric ("at war with the entire Western World") does not change the practical realities of the group.

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Holiday Inns Inc. v. Aetna Ins. Co., 571 F.Supp. 1460 (S.D.N.Y. 1983)

- Beirut hotel damaged by bombings in 1975-1976.
- Insurer: damage precluded because caused by "insurrection, civil war, and war."
- S.D.N.Y. rejects argument; finds that damage was caused by a series of factional "civil commotions," of increasing violence.

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Application of the War Exclusion in an Age of Terrorism

September 11, 2001

- President George W. Bush: Declares 9/11 was an "act of war."
- Would the insurance industry invoke the war exclusion to preclude coverage?
- US House Financial Services Committee issues opinion letter to NAIC.

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Application of the War Exclusion in an Age of Terrorism

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September 11th Litigation

- No reported cases of an insurer asserting war exclusion to preclude coverage.

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In re Sept. 11 Litig., 931 F.Supp.2d 496 (S.D.N.Y. 2013), aff'd, 751 F.3d 86 (2d Cir. 2014)

- One case addressed the analogous act-of-war defense in CERCLA.
- Owner of building near the World Trade Center Towers brought an action under CERCLA for cleanup and abatement expenses for removing pulverized dust after the collapse of the World Trade Center Towers.
- American Airlines, United Airlines and their insurers asserted the CERCLA act-of-war defense in arguing that they did not owe the building owner cleanup and abatement expenses under CERCLA.

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In re Sept. 11 Litig., 931 F.Supp.2d 496 (S.D.N.Y. 2013), aff'd, 751 F.3d 86 (2d Cir. 2014)

- Court found that the airlines and their insurers did not qualify as an "owner or operator" of the hazardous substances or any "other responsible person[s]" for the release of a hazardous substance, and therefore, could not be sued under CERCLA.
- However, the court did find that, even if these entities could be sued under CERCLA, the act of war defense would be applicable in precluding liability and/or coverage.

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After September 11th

- Insured losses totaled $32.4 billion
- Reinsurers begin to exclude terrorism from coverage in January 2002
- ISO drafts and NAIC approves terrorism standard exclusion for liability and property insurance
- 45 states and D.C. approve

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Federal Terrorism Risk Insurance Program

- Congress enacts Terrorism Risk Insurance Act of 2002
- Series of reauthorizations in 2005, 2007 and 2015
- Backstop for Insurers

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Federal Terrorism Risk Insurance Program

- Certain lines of property and casualty insurance must participate and cannot exclude terrorism
- ISO forms track statute
- Government reimburses insurers after they pay a certain amount of claims
- 2017: Government share of losses = 83%

  Aggregate insurance industry losses needed to trigger government reimbursement = $140M
- $100B cap on government contribution

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Federal Terrorism Risk Insurance Program

- Requires certified act of terrorism
  - Violent act that is dangerous to U.S. life, property or infrastructure
  - Part of an effort to coerce U.S. population or policy
  - Aggregate property and casualty losses > $5M
  - Not part of a war declared by Congress

Boston Marathon Bombing - 2013

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Standalone Terrorism Insurance

- Typically does not require certified act of terrorism
- Broader coverage terms, wider geographic area, high limits
- Terms up to 3 years

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Nuclear, Biological, Chemical and Radiological Terrorism

- Not covered by Federal Terrorism Risk Insurance Program
- Nuclear Exclusions and Pollution Exclusions are ubiquitous
- Some standalone NBCR coverage is available

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Cyberterrorism

- Federal Terrorism Risk Insurance Program is silent
- It is possible that a cyberterrorism event could be certified, but
  - Property policies require damage to tangible property
  - General liability policies have not consistently been held to apply to cyber events
  - Professional liability policies are not part of the Program

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Judicial Interpretation

- Jerez v. Republic of Cuba:
  - Acts of torture in Cuba did not result in damage in U.S. or attempt to coerce U.S.
- Miscellaneous cases on 2002 exclusions and whether tenants or borrowers had to buy terrorism insurance

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Judicial Interpretation – Pending Case

- Universal Cable Productions LLC v. Atlantic Specialty Ins. Co.
  - Entertainment companies sued production carrier after they moved TV production from Israel when rockets were fired from Gaza Strip
  - May interpret war exclusion and terrorism coverage

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Questions?

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How Are Building Product Class Actions Weathering?

2017 Annual Meeting
May 11-12, 2017
Chicago, IL

Janet R. Davis
Lee H. Ogburn
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Building Product Class Actions

- Historical Overview of Predominance Requirement
- Current State of Building Product Class Actions
- Duty to Defend Considerations
  - When is the duty to defend triggered?
  - Allocation of defense costs
  - Impact of covered and uncovered claims

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Class Actions' Predominance Requirement

- Rule 23(b)(3) permits class certification if questions of law or fact common to class members predominate over questions affecting only individual class members.
- *Amchem Prod., Inc. v.* Windsor (1997)
  - Supreme Court holds certified class settlement did not meet Rule 23(b)(3) predominance requirement due to individual nature of class members' asbestos bodily injury damages.

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Class Action Predominance Trilogy

- Supreme Court, led by Justice Scalia, followed *Amchem* in rejecting proposed settlement classes finding individual damages determinations and proposed damages model could not be applied on class-wide basis.
- *Wal-Mart Stores, Inc. v. Duke* (2011)
- *Comcast Corp. v. Behrend* (2013)

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Current State of Building Product Class Actions

- In spite of *Amchem*, increase in building product class actions since 2000.
- Cause is use of mass-produced products—often untested—in residential housing leading to construction defect class actions.
- Why do class counsel continue to file in spite of Predominance Trilogy?
  - Non-trivial number of classes have been certified.
  - Rewards are great for class counsel if they prevail on certification.

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The 7th Circuit Knows Best?

- 7th Circuit does not find Class Action Predominance Trilogy impediment to class cert in building product class actions
- *In re IKO Roofing Shingle Products Liability Litigation* (Easterbrook, 2014)
  - District court mistaken that "commonality of damages" is legally indispensable.
- *Butler v. Sears* (Posner, 2013, *cert denied* 2014)
  - "It would drive a stake through the heart of the class action device…that every member of the class have identical damages."

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Not So Fast, 7th Circuit…

- D.S.C. rules against certification in two Pella MDL cases
  - *Romig v. Pella* and *Naparala v. Pella* (June 3, 2016)
  - Proposed classes met Rule 23(a) requirements of ascertainability, numerosity, commonality, typicality, and adequacy of class representation.
  - But class cert denied based on finding that individual issues re causation and damages predominated over common liability issues.

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Not So Fast, 7th Circuit…

- D. N.J. denies class certification in "shingle" case
  - *Stern v. Maibec, Inc.* (March 2017)
  - Maibec opposition to class cert cites numerous cases denying class cert and finding that multiple individualized issues defeat predominance.
  - Maibec cites authority for the proposition that the trend is against certification of building product classes.

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Class Certified? Settlement Imminent…

- Bifurcation of class action trial where common question of liability but individual damages.
- But few cases make it to Phase 2—most cases settle after certification so not much of a roadmap for trials of building product class actions.

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Duty To Defend Considerations

1. Does the duty exist?
    a. The alleged conduct of the insured.
    b. The relief sought.
2. Allocation of defense costs.
3. Who defends these cases?
4. Who selects counsel?

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The Conduct of the Insured

- Class counsel will (almost) always allege non-intentional conduct
  - But you never know, early *Pella* complaint
- If unintentional wrongful conduct alleged: the defective workmanship rationale applies:
  - If consequential damage is alleged, unintentional conduct is almost always an "occurrence"
  - If no consequential damage is alleged, the "occurrence" rule applies, but it doesn't matter – "your product" exclusion
- In a minority of states, even consequential damage may not be caused by an "occurrence":
  - Pennsylvania
  - Wisconsin
  - Anywhere else?

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The Relief Sought

- Two categories of relief for insurance purposes:
  - Just replacement of the allegedly defective product
  - Replacement of the product *plus* damages for consequential damage

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Replacement of Product

- Typically, no potential for coverage
  - The "your product" exclusion
  - No "property damage"
    - *Pozzi*
    - *Moore & Associates*

- But, what about damage caused by replacement?
  - Typically "rip and tear" and not covered

- But better check
  - *Buckhorn v. Lumbermens,* 1988 WL 106624 (Ohio App.)

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Replacement Plus Consequential

- Typically, allegations of consequential damage create the potential for coverage, but
  - *Kvaerner* and *Gambone* in Pennsylvania
  - *Kolbe & Kolbe* in Wisconsin – the "integrated systems" doctrine

- Indemnity issue:

  If consequential damage is alleged, is "rip and tear" to replace product covered?
  - *Pavarini* and *Carithers* under Florida law
  - *Pella* April 2017 decision

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Allocation of Defense Costs

- Building product class actions concern extended periods of time and multiple triggered policies
- Majority Rule — Time On The Risk
- Equal Shares — Georgia and Minnesota

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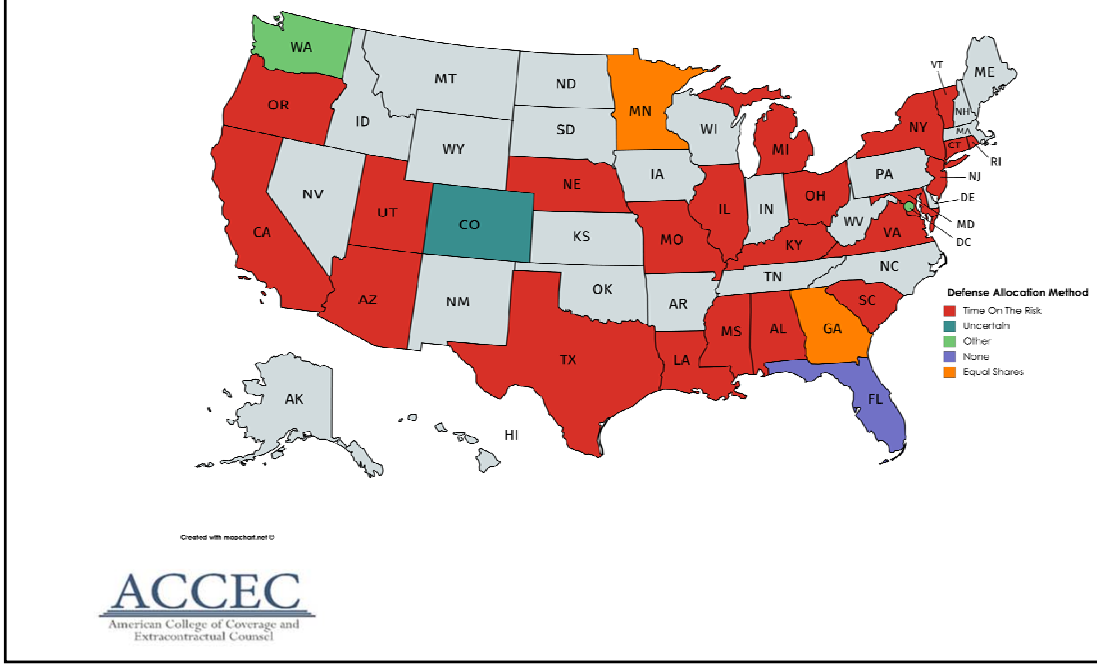

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Defense Counsel

Building Product Class Actions Are Defended By National Firms

- Tamko — Skadden
- Kolbe & Kolbe — Foley & Lardner
- Pella — Faegre Baker Daniels, LLP
- GAF Timberline Defective Roof Shingles — Sullivan & Cromwell LLP
- Goodyear — Ballard Spahr, LLP
- Louisiana-Pacific Corporation — Bingham McCutchen
- Trex Company — K&L Gates LLP
- Barrette Outdoor Living, Inc. — King & Spalding LLP
- Weyerhaeuser Company — Perkins Coie
- Atlas Roofing — Womble Carlyle

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Who Selects Counsel?

- Restatement of the Law of Liability Insurance §16:

  "When an insurer with the duty to defend provides the insured notice of a ground for contesting coverage . . . And there are facts at issue that are common to the legal action for which the defense is due and to the coverage dispute, such that the action could be defended in a manner that would benefit the insurer at the expense of the insured, the insurer must provide an independent defense of the action."

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Certification of Only Uncovered Claims

- Does the certification order terminate the duty to defend?
  - *Del Web Coventry Homes, Inc. v. National Union Fire Ins. Co., 2014 WL 7639486 (C.D. Cal. Nov. 19, 2014)*
- What if covered individual claims remain in the lawsuit?
  - *Universal Underwriters Ins. Co. v. CARSDIRECT.COM*, 2003 WL 22669016 (C.D. Cal. Oct. 28, 2003)
  - *Restatement of Law of Liability Insurance § 13(1)*

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Certification of Only Uncovered Claims

- Terminating events and certification orders
  - *Restatement of Law of Liability Insurance § 18(1)-(8)*
  - *Del Web Coventry Homes, Inc. v. National Union Fire Ins. Co., 2014 WL 7639486 (C.D. Cal. Nov. 19, 2014)*
- Does the potential for liability still exist?
  - What will the release in the settlement agreement include?

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"FOOD RECALL INSURANCE"
KEEPING IT FRESH

2017 Annual Meeting

May 11-12, 2017

Chicago, IL

Suzan F. Charlton, Covington & Burling LLP

Julia Molander, Cozen O'Connor

Arthur S. Garrett III, Keller and Heckman LLP

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OLIVER IN 21ST CENTURY AMERICA

- "Food Poisonous Food" or "Is Gruel the better option?"

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Food poisonous food

You don't want to try it

Three recalls a day

The FDA diet

Listeria, e coli

What next is the question?

Could it be food poisoning,

Or indigestion?

Food poisonous food

Your client's big downfall

Try not to get sued

Maybe just a recall

One undeclared allergen

Or campylobacter

Ingredient suppliers

Could be a factor!

Food poisonous food

Could there be insurance?

Insurers are screwed

If there's an occurrence

Don’t be a mere processor

“Your work” is exclu-ded

Food!

Dangerous food!

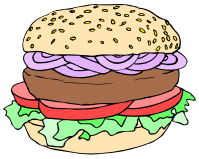
Hazardous food!

Poisonous food!

RECENT FOOD CONTAMINATION SITUATIONS

- Spinach
- Pomegranates
- Peanuts
- Chicken
- Pistachios
- Cumin
- Ice Cream

- **Soft Cheese**
- **Peanut Butter**
- **Ground Beef**
- **Parsley**



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FOOD RECALL INSURANCE

- What is "Food Recall Insurance?"
  - A Comprehensive Insurance Program Tailored for a Food Company
    - Manufacturer
    - Supplier
    - Retailer
    - Co-Packer
  - The Program includes: GL Insurance, Property, D&O, Product Contamination (Recall) Insurance

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CGL, Property and D&O Coverage

Traditional Insurance

- CGL
- Property Coverage
- D&O

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CGL, Property and D&O Coverage

CGL

- "Bodily Injury"
  - Sickness due to Contamination
- "Property Damage"
  - Incorporation of a tainted ingredient into an otherwise unadulterated food could be enough to cause "property damage"
- Exclusions
  - Contamination
  - "Business risks" (your work/product, impaired property, *recall)*

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CGL, Property and D&O Coverage

Commercial (First-Party) Property

- If the company can show "physical injury to tangible personal property" then it could be entitled to recover via different valuation approaches
- What if the recalled product has not yet suffered "physical injury"? Are costs associated with the recall or decontamination efforts covered?

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CGL, Property and D&O Coverage

D&O

- Follow-up by FDA/DOJ

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PRODUCT CONTAMINATION INSURANCE

PCI - Basic Coverage for Accidental Contamination

- Business Interruption
- Lost Gross Profit
- Rehabilitation Expenses
- Crisis Management/Consultants
- Recall Expenses
  - Transportation/disposal of product, replacement product, additional personnel/overtime, expenses for rental of warehouse space for storage, notification to third parties, combing supermarket shelves to remove contaminated product, cleaning equipment, laboratory analysis

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PRODUCT CONTAMINATION INSURANCE

What Triggers Coverage?

- ~~voluntary recall of product~~
- ~~mandatory, government-ordered recall of product~~
- ~~recall due to possibility that product might cause serious adverse health consequences or death~~
- recall because of known or suspected defect … which has caused or is reasonably expected to cause bodily injury or physical injury to tangible property other than your product.

Costs

- Business Interruption
- Lost Gross Profit
- Rehabilitation Expenses
- Crisis Management/Consultants
- Recall Expenses
  - Transportation/disposal of product, replacement product, additional personnel/overtime, expenses for rental of warehouse space for storage, notification to third parties, combing supermarket shelves to remove contaminated product, cleaning equipment, laboratory analysis

PRODUCT CONTAMINATION INSURANCE

- Trigger is the key
  - Policies only apply to recalls necessary when the policyholder's contaminated food "has resulted in or would result in bodily injury" or property damage. . .
  - Or as at least one policy puts it, "may likely result in bodily injury" or property damage . . .

Endorsements

- Government Recall Endorsement
- Adverse Publicity Endorsement
- 3rd-Party Recall Liability Provision
- Product Refusal Provision

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THE PURCHASE/SALE OF A PCI POLICY

- What is the recall policy's conceptual framework?
- Part of a business package policy?
- "Liability" coverage for first-party losses?
- "Bare bones" coverage with added coverage by endorsement?
- Types of insured events covered?
- Types of damages covered?

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THE PURCHASE/SALE OF A PCI POLICY

- What claims services does the insurer provide?
- Crisis Management/PR/Customer Contact?
- Accounting and Legal?
- Warehousing/Product Destruction/Reclamation?
- Food Safety Specialists for Identifying Root Causes of Contamination?

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THE PURCHASE/SALE OF A PCI POLICY

- What are the co-insurance arrangements?
- Is there an SIR or a deductible?
- What part of the loss satisfies the deductible?

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THE PURCHASE/SALE OF A PCI POLICY

- What must be disclosed in the application?
- Prior contamination?
- Failure to take corrective measures?
- Knowledge (objective/subjective) of executives?

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THE RECALL/FOOD CONTAMINATION CLAIM

- How does the insured present the loss?
- Notice to the insurer before the actual recall?
- Are there crisis management consultants as part of coverage? Sublimits? Outside the SIR?
- Are there forensic accountants as part of coverage? Sublimits? Outside the SIR?

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THE RECALL/FOOD CONTAMINATION CLAIM

- What should be the insurer response to a covered loss?
- Does the policy have limits on the range of loss categories?
- Are there some losses cannot immediately be calculated, like loss of market share?
- How does the policy evaluate the monetary loss of returned product?
- Does the policy compensate for loss of goodwill, bad publicity?
- How are gross and net profits defined in the policy?

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THE RECALL/FOOD CONTAMINATION CLAIM

- Are there subrogation opportunities?
  - Pomegranate Case Discussion (*TFI v. Goknur*, 2017 Fed. Dist. Ct., California)
- Should the insurer pay first and subrogate?
- If there are losses outside of coverage should the insured pursue and then seek to collect the covered losses from the insurer?
- How do the insurer and the insured work together to keep from trampling on each other's recovery rights as against third parties?

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THE RECALL/FOOD CONTAMINATION CLAIM

- How does the insurer respond to uncovered/questionably covered losses?
- Were there prior incidents of contamination?
- Would it be appropriate to hire an expert early?
- Was the claim timely made and reported?
- Was a voluntary recall reasonable if not compelled by a governmental agency?

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DISCUSSION

- Should insurers attempt to standardize their specialty recall offerings? Advantages and disadvantages?
- Inconsistency in coverage triggers, particularly re actual contamination requirement and actual (or likely? or possible?) bodily injury requirement.
- To the extent that coverage is not standardized and may be negotiable, what would be your top tips for policyholders at application/renewal time when negotiating coverage for recall incidents?
- Advice for claims: Issues with adjustment and documentation requirements?
- "Additional insured" and Subrogation issues when multiple parties in the food chain are involved?

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PRACTICAL TIPS WHEN PURCHASING RECALL/CONTAMINATION INSURANCE

- Negotiating with the PCI insurer to soften the government recall coverage trigger from "mandate" to "recommendation"
- Negotiating the "other insurance" provision with the primary CGL carrier so that the insured's carrier responds on behalf of the insured in the event of an outbreak and not the supplier's carrier on which policy the insured is an additional insured
- Disclosures during application/renewal process
- Consistency between primary and umbrella/excess terms

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Master Class: Bad Faith Trial Tactics

Christopher W. Martin
Martin, Disiere, Jefferson & Wisdom
Houston, Texas

Michael Huddleston
Munsch, Hardt, Kopf & Harr
Dallas, Texas

Joyce C. Wang
Carlson, Calladine & Peterson
San Francisco, CA

Barbara A. O'Donnell
Zelle, McDonough & Cohen
Boston, MA

Deposition Issues

- Company Witnesses
- Policyholders

Written Discovery

- E-Discovery Issues
- Shotguns vs. Rifles
- Attorney Fee Discovery

"Institutional" Discovery

- Bonus Plans
- Training Programs
- Post-Claims Underwriting
- Staffing
- CAT Operations
- IA Compensation
- Claims Experts: frequency & compensation
- Document Retention Program
- "Discovery on Discovery"

"Institutional" Discovery

- General Contractor Overhead & Profit
- Depreciation Standards
- Coinsurance Penalty Calculations
- Sales Tax Calculations
- UM/UIM Waivers
- Pricing Guides
- Customer/DOI Complaints (or Logs)
- Other Bad Faith Lawsuits
- Carrier Computer Data

"Institutional" Discovery

- Strategic Considerations
- "Framing" the Issues
- Trial Implications

Witness Prep Issues

- Depo "School"
- Trial Prep Differences

Bifurcation?

- Strategic Considerations
- Trial Implications

Multiple Defendant Cases

- Co-Counsel Issues
- Adjusters/Agents as Trial Defendants

Technical Experts

- Designation & Depo Issues
- Trial Uses & Abuses

Bad Faith Experts

- Do They Ever Make a Difference?
- Proper Strategic Uses

Mock Jury Considerations

- Limited Issue Inquiries
- "Filter" Identification
- Witness & Damage Assessments

Jury Questionnaires

- ALWAYS ask.
- Brevity is Key.
- Content Issues: Don't Ask Panel What You Now Know

Witness Prep Issues For Trial

- Differences with Depo Prep
- The Order of Testimony -- Prepping to be Crossed First
- The Structure of Testimony: Think "Rebuttal"

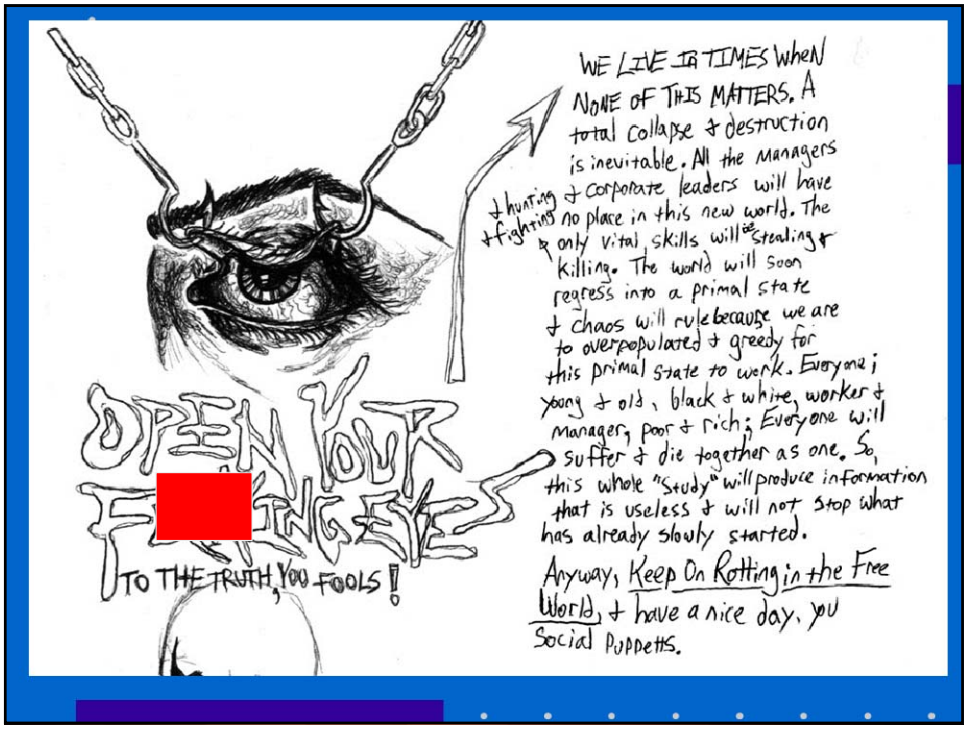
Bad Faith Case Themes

- You Need One.
- Proper Use of Case Themes

The Danger of Biased Stereotypes

"The Baptists are more hopeless than the Presbyterians. They too are apt to think the real home of all "outsiders" is Sheol, and you do not want them on the jury, and the sooner they leave the better… If chance sets you down between a Methodist and a Baptist, you will move toward the Methodist to keep warm."

- Clarence Darrow, *Esquire Magazine*, May 1936, p.48



Frequent Voir Dire Mistakes

- Cross Examination, rather than "Therapy"
- No "Looping"
- Lack of "Range" Questions

Graphics & Trial Technology

- Electronic Exhibits
- Effective Use of Demonstratives
- The Abuse of Video Depositions?

Dealing with "Bad Facts?"

- Own them & Integrate
- Cover early – voir dire, opening statement
- Address on direct examination
- Create true context for processing "bad facts" or "bad" documents

Swaying Unsympathetic Jurors

- Take the offensive
- Direct your experts to answer the unasked questions of the skeptics.
- Reframing the "Justice" Issue

Trying The Institutional Bad Faith Case

- Turning the Tables: "Go Big"
- Re-Focusing the Jury: What's Really at Issue
- Re-Focusing the Jury: Don't Forget the Plaintiff
- Unique Witness Issues

ATTORNEYS FEES RECOVERY

ACCEC Annual Meeting
May 11, 2017

Robert D. Allen, The Allen Law Group
Nicholas Nierengarten, Gray Plant Mooty
Sara M. Thorpe, Nicolaides Fink Thorpe Michaelides Sullivan LLP

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Introductions

- Robert D. Allen, The Allen Law Group
- Nicholas Nierengarten, Gray Plant Mooty
- Sara M. Thorpe, Nicolaides Fink Thorpe Michaelides Sullivan LLP

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Attorneys Fees Recovery
- Overview of Presentation

- Coverage for attorneys fees awarded against insured
  - Damage
  - Cost and the Supplementary payment provision
- Defense costs recovery where disputed
  - Reasonable and necessary
- Coverage for attorneys' fees incurred seeking insurance coverage
  - By contract, statute, case law
  - When there is "bad faith"

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Hypothetical

- Insured, a real estate developer, sued for construction project where siding selected for the homes is graying and peeling because it was not the correct siding for the area and conditions.
- Contract between developer and owners of the homes has attorneys fee provision – fees to be paid to prevailing party.
- Insured loses the case. Found to have used wrong siding for the conditions so homes are unsightly and have to be completely re-sided.
- Homeowners awarded their attorneys fees of $1.5 million.
- Insured has general liability insurance. Insurer refused to defend. Insured selects defense counsel.
- Insurer refused to pay judgment claiming no property damage.
- Insured sued insurer for coverage for defense and judgment.

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Right to Attorneys Fees

- American Rule: each party bears its own attorneys' fees in litigation
- Only exceptions are a contract, statute, rule, or case law authorizing the shifting of legal fees from the prevailing party to the losing party

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Right to Attorneys Fees

- Contract – parties agree that, if there is a dispute, prevailing party can recover attorneys fees, e.g.,
  - Landlord – tenant
  - Construction project
  - Real estate

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Right to Attorneys Fees

- Statutory (statutes and rules), for example, in Texas:
  - Tex. Civ. Prac. & Rem. Code §37.001 (breach of contract)
  - Tex. Civ. Prac. & Rem. Code §38.009 (state court declaratory judgment actions)
  - Tex. Ins. Code §541.152 (unfair claims handling practices)
  - Tex. Ins. Code §542.541 (breach of prompt payment of claims)
  - Tex. R. Civ. P. 91a (actions not based in law or in fact)
  - Fed. R. Civ. P. 37(b)(2)(C) (federal court discovery sanctions)

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Right to Attorneys Fees

- Case law
  - Recovery of attorneys fees to insured seeking coverage if insurer acted in bad faith, *Brandt v. Superior Court,* 37 Cal. 3d 813, 817 (1985)

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Coverage for Attorneys Fees Awarded Against Insured

- Damages or Costs
  - Damages
    - Amounts to compensate party (to put person in place would have been if had not been a breach)
    - Contract provides that in contract dispute, prevailing party entitled to attorneys fees
  - Costs
    - Amounts awarded to prevailing party by statute, e.g., Cal. Civ. § 1033.5(b)(5) (if statute refers to award of "costs and attorney's fees," then attorney's fees are an item of costs)
    - For costs of litigating, rather than item of damage, e.g. *Cutler-Orsi Unified School Dist. v. Tulare Co.,* 31 Cal. App. 4th 622 (1994) (attorney fees awarded under Voting Rights Act "does not compensate the plaintiff for the injury that first brought him into court[;] [i]nstead, the award reimburses him for a portion of the expenses he incurred in seeking ... Relief")

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Coverage for Attorneys Fees Awarded Against Insured

- Damage – hypothetical
  - Construction case
    - Insured lost case and HOA awarded attorneys fees ($1.5 million)
  - Whether what contractor has to pay is covered by his insurance policy depends on whether considered damages or cost, and then whether policy covers this type of damages or these costs

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Coverage for Attorneys Fees Awarded Against Insured

- If Attorneys Fees are Damages
  - Depends on whether covered damages, e.g.
    - Under general liability policy, damages for property damage or bodily injury or advertising or personal injury
    - Under professional liability policy, fall within "damages" definition (which does not include, for instance, return of fees, contractually owed amounts)

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Coverage for Attorneys Fees Awarded Against Insured

- If Attorneys Fees are Costs
  - "Supplementary Payments" provision of policy: "costs taxed against insured"
    - If duty to defend, then duty to pay these costs
  - However, policies may limit this to costs associated with covered claims, e.g., definition in Supplementary Payments provision or by endorsement only pays for costs associated with covered claims

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Defense Costs Recovery

- Hypothetical
  - Insurer refused to defend contractor
  - Issues
    - Rates
    - Billing practices (e.g., “block billing”)
    - “Overhead” (e.g., clerical, bate stamping, in-house conference)
  - Tension-producing: deductions, audits

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Defense Costs Recovery

- Standard
  - Reasonable
  - Necessary to insured’s defense
- Documentation
  - Explanation as to reasonableness
- Use of expert

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Coverage for Attorneys Fees Incurred Seeking Insurance Coverage

- Again, American rule, so only when allowed by contract, statute, rule, case law
- Contract versus extra-contractual obligation
  - Remedy for insurer's breach of contract
    versus
  - Remedy only if insurer acted in "bad faith"

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Coverage for Attorneys Fees Incurred Seeking Insurance Coverage

- Hypothetical – construction case
  - Suit to obtain coverage (attorneys fee award, damages awarded to HOA, defense costs)
  - Also right to attorneys fees incurred in pursuing coverage?

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Coverage for Attorneys Fees Incurred Seeking Insurance Coverage

- Contract – rarely (never?) are attorneys fees provided for in the insurance policy

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Coverage for Attorneys Fees Incurred Seeking Insurance Coverage

- Breach of contract, e.g., (hypothetical) – by statute, rule, case law, e.g.:
  - Texas statutes
  - Washington – *Olympic Steamship Co. v. Centennial Ins. Co.*, 811 P.2d 673 (Wash. 1991)

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Coverage for Attorneys Fees Incurred Seeking Insurance Coverage

- Requires bad faith (breach is not enough)
  - California – *Brandt v. Superior Court,* 37 Cal. 3d 813, 817 (1985)

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Coverage for Attorneys Fees Incurred Seeking Insurance Coverage

- Procedural issues
  - During trial (by jury)
  - Post-trial (by Judge)
- Burden of proof
- Standard
  - "Lodestar"
  - Reasonable and necessary
  - Not to prove "bad faith"

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Coverage for Attorneys Fees Incurred Seeking Insurance Coverage

- Insurer arguments
  - Rates
  - Failure to segregate between covered/non-covered
  - Duplicative, block billing, vague
- Policyholder arguments
  - Estoppel to contest due to breach of duty to defend

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ATTORNEYS FEES RECOVERY

Thank you

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Allocating the Defense: Two Perspectives on *Arceneaux* and Beyond

2017 Annual Meeting

May 11-12, 2017

Chicago, IL

Laura A. Foggan, Crowell & Moring LLP

Jay Russell Sever, Phelps Dunbar LLP

Martin C. Pentz, Foley Hoag LLP

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The *Arceneaux* Decision

- In 2016, in *Arceneaux v. Amstar Corp.*, the Supreme Court of Louisiana addressed whether and how the cost of defense ought to be allocated among multiple insurers in a long-tail exposure claim covered by commercial general liability ("CGL") insurance.
- The insured, American Sugar Refining, Inc., was sued by approximately 100 former employees. The former employees alleged that they were exposed to loud noise while working for American Sugar and suffered resulting hearing loss. The exposures allegedly occurred during various years from 1941 until 2006.
- The insurer, Continental Casualty Company insured American Sugar from 1963 to 1978, although bodily injury to employees was excluded for most of this period, excepting only some 26 months during the period 1975 to 1978. Continental thus was on the risk for about 26 months out of more than 60 years of exposure, and American Sugar evidently had no coverage for much of the remaining time.

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The *Arceneaux* Decision

- American Sugar sought full coverage of its past defense costs and asked Continental to provide a complete defense going forward.
- Continental agreed to pay only 25% of the defense (subject to a full reservation of rights) on a theory that responsibility for defense costs should be prorated across the full period of exposure.
- The Continental policy employed widely-used wording for the pertinent definitions:
  - "Bodily injury" was defined as "bodily injury, sickness or disease sustained by any person which occurs during the policy period, including death at any time resulting therefrom."
  - "Occurrence" was defined as "an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured."

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The *Arceneaux* Decision

- The Supreme Court of Louisiana noted that "there appears to be no Louisiana precedent on the precise issue the court is presented with in this case, which is whether an insurer's duty to defend may be prorated among insurers and the insured during periods of self-insurance in long latency disease cases."
- The Court held that Continental would only be liable for its pro rata share of American Sugar's defense, based strictly on Continental's time on the risk, which was about 3.3% and 3.7% in the two cases addressed by the appeal.
- Among other reasons, it observed that the policy language limited coverage to bodily injury occurring during the policy period, that Louisiana tort law does not include the concept of joint and several liability, and that adopting joint and several liability for defense costs could inappropriately reduce incentives for policyholders to maintain continuous coverage.

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Significance of *Arceneaux:* Insurer Perspective (Foggan/Sever)

- Part of a trend by courts across the country toward a more equitable system of allocating defense costs in long latency injury claims.

- In reaching the conclusion that pro rata is more appropriate than the joint and several allocation method for defense, these courts tend to focus on the following factors:
  (1) policy language/contract interpretation;
  (2) reasonable expectations;
  (3) equity/public policy; and
  (4) judicial economy.

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Significance of *Arceneaux:* Insurer Perspective (Foggan/Sever)

Policy language/contract interpretation:

The *Arceneaux* court recognized that the policy language itself limited "coverage for bodily injury to that which occurs during the policy period."

Moreover, the courts have discounted the "all sums which the insured shall become legally obligated to pay as damages" language — *i.e.,* the language courts cite to support application of the joint and several allocation method. This language, according to the courts, does not bear the interpretation that the insurer should be liable for injuries that do not occur during the policy period and, consequently, that the insurer should be liable for all defense costs relating to such injuries

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Significance of *Arceneaux:* Insurer Perspective (Foggan/Sever)

Reasonable expectations:

Neither the insurers nor the insured could reasonably have expected that the insurers would be liable for losses occurring in periods outside of their respective policy coverage periods.

More specifically, "[n]o reasonable policyholder could have expected that a single one-year policy would cover all losses caused by toxic industrial wastes released into the environment over the course of several decades." *Boston Gas Co.,* 454 Mass. at 363.

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Significance of *Arceneaux:* Insurer Perspective (Foggan/Sever)

Equity/public policy

In *Arceneaux*, the court explained that a pro rata allocation is "reasonable" because the joint and several scheme "would treat an insured who had uninterrupted policies for twenty years the same as an insured who had a triggered policy for one year." To hold otherwise, would entitle an insured to receive coverage for a period in which it did not pay a premium.

The joint and several liability approach provides a disincentive to insureds to obtain uninterrupted insurance coverage and would result in a windfall to those companies that had broken chains of insurance.

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Significance of *Arceneaux:* Insurer Perspective (Foggan/Sever)

Judicial economy:

The joint and several allocation approach, according to the court, is inefficient in that it does not ultimately resolve the allocation issue. Instead, the issue is postponed and divided into two parts — the policyholder first chooses the triggered insurer to pursue and second, the triggered insurer then sues other insurers for contribution.

As a result, the joint and several approach increases litigation costs, which are then passed on to policyholders via higher premiums, whereas the pro rata approach resolves all coverage and allocation issues in a single proceeding.

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Paying A Pro Rata Share/Reimbursement (Foggan/Sever)

Based on the pro rata allocation method, an insurer is obligated to pay only its share of defense costs attributable to harm that took pace during its policy period.

An insurer that is providing a complete defense to an insured is entitled to reimbursement of defense costs for uncovered claims, including those claims that are not triggered for that policy period or those claims that otherwise are not covered under the terms and conditions of a policy. In support of reimbursement, courts similarly look to the policy language, as well as equity and public policy.

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The Pro Rata Allocation of Defense Costs and its Application to Other Case Types (Foggan/Sever)

Pro rata allocation of defense costs should not be limited to long-tail environmental cases, as the logic underlying it should be extended to apply to any claim involving multiple years of coverage, multiple policies, or gaps in coverage.

Examples of such case types include (but are not limited to):

- construction defect claims,
- products liability claims,
- the non-environmental aspect of oil and gas claims, and
- continuous bodily injury claims (sexual molestation or abuse).

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The Absence of Coverage Has No Impact on a Pro Rata Allocation (Foggan/Sever)

- Under the pro rata allocation approach, an insured's lack of coverage vis-à-vis a coverage denial, uninsured years or a self-insured retention has no bearing on the method of allocation for defense costs.

- To accurately formulate an insurer's pro rata share, the court must take into account **all** years of damage regardless of whether coverage is available to the insured. Such a formulation is the only fair and equitable means of applying this approach.

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Significance of *Arceneaux:* Policyholder Perspective (Pentz)

***Arceneaux* Fails to Address Unique Attributes of the Defense Duty and Offers No Compelling Rationale for "Defense Proration"**

- Ignores unitary nature of duty "to defend."
- Incorrectly assumes proportionality rationale underlying indemnity proration also applies to defense.
- Misapprehends equitable considerations.
- Relies on incentives analysis that does not reflect insurance-purchasing realities.
- Exaggerates supposed "judicial economy" advantage of proration.
- Reflects unique attributes of Louisiana law.

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Significance of *Arceneaux:* Policyholder Perspective (Pentz)

***Arceneaux* Ignores Unitary Nature of Insurer "Right and Duty" to Defend**

- CGL policies provide insurer with "right and duty" to "defend" – not just an obligation to pay or reimburse defense costs or some fractional portion thereof.
- To defend means to retain counsel, investigators and experts, to supervise their activity, to determine strategy, etc. Not something that can be divided into pieces.
- If the policies had contemplated sharing of defense, they would have provided a process and formula for same; how governance happens, how to resolve disagreements. Not addressed.
- Reservation of a "right" to defend, *i.e.*, to control the defense, is valuable to insurers, who sometimes waive reservations to keep it. Conceptually incompatible with proration.

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Significance of *Arceneaux:* Policyholder Perspective (Pentz)

Proportionality Theory Underlying *Pro Rata* Allocation Does Not Apply to Defense

- *Pro rata* theory said to be needed due to infeasibility of fact-based allocation to policy periods; some case law favors fact-based allocation where possible (*Boston Gas*, *PEM*).
- Underlying rationale posits that there is at least a direct relationship between length of exposure and degree of injury, if not a strictly proportional one.
- Same cannot be said of burden of defense undertaking, which is often entirely unrelated to exposure time. *Boston Gas*, 910 N.E.2d at 311 n.38.
- That claimant's exposure was five or ten or twenty years will rarely affect what must be done to defend or how much defense will cost.
- Also, nonsensical to say parties expected defense duty to be allocated when defense is needed at outset of suit – as facts needed for proration will be unknown at that time.

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Significance of *Arceneaux:* Policyholder Perspective (Pentz)

Equitable Considerations Do Not Support Proration Of Defense

- If insurer has "right" to "defend" a mixed claim, then it should not be heard to contend it can fractionalize and convert to partial reimbursement, when "duty" to "defend" arises
- Results of *pro rata* allocation bear no relation to impact of "extra years" on cost of defense
- If equitable principles trump policy language, then *Buss* approach better serves the purpose: Insurer would defend with right to recoup only those defense costs it can show to be *exclusively* attributable to out-of-policy-period injury
- Particularly inequitable to permit assignment of costs to post-exposure periods before manifestation. New injury or disease phenomenon comes to the fore and insurers exclude it; coverage becomes unavailable. Yet, under pro rata theory, if it takes another twenty years for harm to manifest, insurer's "share" shrinks to vanishing with the passage of time.

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Significance of *Arceneaux:* Policyholder Perspective (Pentz)

Reasonable Expectations: Manipulative Insurance Purchasing Scenarios Ring Hollow

- Policyholders should seek to persuade courts to steer clear of speculation about expectations.
- *Boston Gas* musing that no reasonable policyholder would expect a single-year policy to cover decades of exposure is mistaken. That's exactly what a claims-made policy would do, subject only to "retroactive date."
- Policyholders will not deliberately cease purchasing insurance, depending on old policies to cover years of continuing injury.
  - Would leave company with no coverage for accidents taking place, or exposures beginning, in later years.
  - Coverage gaps typically do not arise from purchasing manipulation, but from lost policies, insurer insolvency and unavailability of coverage based on industry-wide exclusions.

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Significance of *Arceneaux:* Policyholder Perspective (Pentz)

Proration of Defense Largely Neutral to Judicial Efficiency

- Assuming insurer contribution rights vis-à-vis defense, so-called re-allocation proceedings can be pursued by third-party complaint in same action.
- "Other Insurance" provisions of CGL policies contemplate methods of sharing. Litigation among insurers may not be necessary.
- *Pro rata* approach, on the other hand, virtually assures policyholder will need to join all insurers "on the risk" in litigation.

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Significance of *Arceneaux:* Policyholder Perspective (Pentz)

Louisiana Supreme Court Holding Expressly Limited in Several Ways:

- "Joint and several" concept not recognized in Louisiana law.
- One concurring opinion attributed the result to the unique context of Louisiana law regarding long latency occupational disease cases. Not clear whether would be extended to property damage or different disease etiologies.
- Expressly tied to wording considered (1973 ISO Standard Provisions); may not be controlling even in Louisiana under other wordings.

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Significance of *Arceneaux:* Policyholder Perspective (Pentz)

Declaration of "Trend" Premature

- Proration of defense costs also recently rejected in *Peabody Essex Museum v. U.S. Fire*, applying the law of a jurisdiction (Massachusetts) that has endorsed proration of indemnity.
- Likewise rejected in states adopting "all sums" extent-of-coverage theory, but expressly premising the ruling as to defense on defense duty "in for one, in for all" precedents *Plastics Eng'g*. (Supreme Court of Wisconsin).
- Neither *Arceneaux* nor *Peabody Essex Museum* grapples with the issue in the sort of depth that is likely to make either a seminal case – such a decision has yet to be rendered.

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Extra-Contractual Liability and the Restatement on Liability Insurance Law

2017 Annual Meeting

May 11-12, 2017

Chicago, IL

Michael F. Aylward, Lorelie S. Masters, Jeffrey E. Thomas

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§ 24 Uses an "Objective" Standard for Settlement Decisions

1) When [the insurer has control over the settlement and there is a potential for an excess verdict] the insurer has a duty to the insured to make reasonable settlement decisions.
2) A reasonable settlement decision is one that would be made by a reasonable insurer who bears the sole financial responsibility for the full amount of the potential judgment.

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Do Insurers have an Affirmative Duty to Initiate Settlement?

d. Applying the reasonableness standard. . . . The duty to make reasonable settlement decisions includes the duty to accept a settlement offer that a reasonable insurer would accept and to make an offer to settle when a reasonable insurer would do so. . . . [2 more paragraphs and 2 illustrations].

f. The insurer's failure to make settlement offers and counteroffers. There is no hard and fast rule regarding the insurer's obligation to make offers. It is a question of what a reasonable insurer would do in the circumstances. In the absence of a reasonable offer by the plaintiff, there are circumstances in which an insurer has a duty to make a settlement offer, such as, for example, a suit in which the policy limits are significantly less than the reasonable settlement value of the case. In such circumstances, the insurer is obligated to attempt to protect its insured . . . . It is important to emphasize, however, that an insurer has no obligation to make an offer unless a reasonable insurer that bore the sole financial responsibility . . . would do so, and there may be good reasons not to.

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§ 51 Adopts a Subjective Standard for Bad Faith

An insurer is subject to liability to the insured for insurance **bad faith** when it fails to perform its duties under a liability insurance policy:

(a) Without a reasonable basis for its conduct; and

(b) With knowledge of its obligation to perform or in reckless disregard of whether it had an obligation to perform.

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"Bad Faith" Examples (?)

- **Bad faith rejection of settlement** – defense counsel and adjuster agreed that settlement offer should be accepted, but supervisor overrules and declines
- **Inadequate or improper investigation** – Illustration includes a supervisor who "directed [the] investigator to change her report" to reflect that the accident was not the insured's fault.
- **Failure to communicate the settlement offer to the insured** – the insurer wants to fight the claim, or thinks the settlement offer is too high, and believes that insured is on-board (or just doesn't care about insured's view); had insured known, it would have demanded settlement

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§ 52 Bad Faith Damages vs. § 27 Damages for Failure to Settle

- **Bad faith damages**:

(1) The attorneys' fees and other costs incurred by the insured in the legal action establishing the insurer's breach;

(2) Any other loss to the insured proximately caused by the insurer's bad-faith conduct; and

(3) If the insurer's conduct meets the applicable state-law standard, punitive damages.

- **Failure to settle damages**:

An insurer that breaches the duty to make reasonable settlement decisions is subject to liability for the full amount of damages assessed against the insured in the underlying legal action, without regard to the policy limits, as well as any other foreseeable harm caused by the insurer's breach of the duty.

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Concluding Remarks

Discussion

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CHANCES ARE . . . A FORTUITY CASE STUDY

Acme Chemical Inc. v. Zenith Insurance Co.

2017 Annual Meeting
May 11-12, 2017
Chicago, IL

Moderator: Susan B. Harwood
Boehm Brown Harwood, PA

For Acme: Bernard P. Bell
Miller Friel, PLLC

For Zenith: Myles A. Parker
Carroll Warren & Parker PLLC

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Disclaimers

- These are hypothetical loss scenarios presented for purposes of continuing professional legal education, and may not be duplicated, shared or used for any purpose other than presentation at the 2017 Annual Conference of the American College of Coverage and Extracontractual Counsel
- The facts presented are composite scenarios based on reported cases and the authors' experiences across multiple property damage insurance claims involving catastrophic industrial losses. They are of "like kind and quality," but are not factually accurate replicas of specific individual claims

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Acme's Insurance Program and Loss

- Claimant Acme Chemical Inc. ("Acme") purchased a program of "all risks" property insurance
- Acme's coverage is governed by terms of policy issued by Respondent Zenith Insurance Company ("Zenith")
- On January 1, 2010, during policy period, a pressure vessel at an Acme facility ruptured, dispersing flammable process material that ignited, causing an explosion and fire that damaged or destroyed Acme's insured property, and caused an interruption of Acme's business
- Zenith Policy provides that New York law shall govern the interpretation and application of the Policy, and that all disputes shall be resolved through binding arbitration in Bermuda

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Cause and Origin of Acme's Loss

- Acme's loss was caused by rupture of a vessel that resulted from damage to vessel's shell caused by internal corrosion, capable of detection only by recognized internal inspection procedures
- The vessel that ruptured was part of a set of three cylindrical vessels through which process material flowed in sequence
- The vessels were part of a process chain that was designed to, and did, operate under both heat and pressure
- The temperature was highest as the process material entered Vessel A, and then decreased through Vessels B and C

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Cause and Origin of Acme's Loss

- The shell of Vessel A, subject to the highest temperatures, was made with an alloy steel and fully clad internally with stainless steel. These materials are less susceptible to corrosion than carbon steel
- The shell of Vessel B was made largely from carbon steel, except for a few feet at the hotter end where it received effluent from Vessel A and was lined internally with stainless steel
- The shell of Vessel C was made from carbon steel
- At equal temperature and pressure, carbon steel is more susceptible than alloy/stainless steel to the type of internal corrosion that caused Vessel B to fail

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Cause and Origin of Acme's Loss

- The particular form of corrosion that caused Acme's loss is a gradually occurring damage mechanism well-known in Acme's industry
- The two critical parameters on which corrosion attack depends are:
  - Temperature of the shell; and
  - Pressure inside the vessel
- Plotting the combination of these two variables results in curves
- Industry standards are developed from experience and published
- These standards set forth operating conditions under which corrosion damage is expected (or not expected) to occur in different kinds of steel

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Cause and Origin of Acme's Loss

- These curves are adjusted over time to reflect new reports of corrosion damage
- For a given type of steel, combinations of pressure and temperature "below" the curve are considered to be safe
- Similarly, combinations of pressure and temperature "above" the curve are not considered to be safe
- These standards constitute recognized and generally accepted good engineering practices (RAGAGEP)

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Acme's Mechanical Integrity Program

- At the time of loss, Vessel B was 40 years old
- A prior owner designed, constructed and installed the vessels in 1970
- Acme bought the facility in 2000
- Acme relied on third-party corrosion experts to evaluate its equipment
- In 2001, 2006 and 2009, these experts reviewed the metallurgy, operating conditions and process of Vessel B for susceptibility to the corrosion that occurred
- As part of the 2001 review, Acme took a temperature reading at the inlet (hot) end of Vessel B, and the reading was within the range thought to be safe. Acme did not regularly monitor the temperature at the inlet to Vessel B
- Between 2006 and 2009, Acme instituted certain process and operational changes that likely increased the temperature and pressure in Vessel B

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Scenario A:

- None of the three corrosion reviews found that Vessel B was susceptible to this form of corrosion
  - One review erroneously assumed that Vessel B was fully clad in stainless steel
  - This assumption was not corrected
  - Vessel B failed at or near the seam between the cladding and the carbon steel
- Each review recommended that Vessel A, but not B, be internally inspected
- Acme included Vessel A, but not B, in program for internal inspection for this form of corrosion damage
- Acme never internally inspected Vessel B for this form of corrosion damage
- Acme was not aware of damage to Vessel B until post-incident laboratory testing
- If Acme had included Vessel B in its inspection program, it is more likely than not that Acme would have discovered the damage

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Scenario B:

- Following the 2009 review, Acme inspected Vessel B and discovered the corrosion damage
- Acme solicited bids, from three international firms with extensive experience and qualifications in Acme's industry, to repair the damage
- Acme elected to perform the repair in 2009 with its own work force, at considerably less cost than the three bids, but without the same level of expertise
- Acme continued to operate the vessels after the repairs without directly measuring vessel shell temperatures or internal pressures
- Post-incident testing determined that
  - The repairs had failed either to address past damage to Vessel B or to prevent future damage; and
  - Vessel B operated at a combination of temperature and pressure above the curve

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Scenario C:

- Following the 2006 review, Acme inspected Vessel B and discovered the corrosion damage
- Acme conducted certain repairs as a temporary patch, and returned Vessel B to service until final repairs could be made
- Zenith was aware of Acme's 2006 decision to return Vessel B to service and wrote to Acme reserving the right to deny any subsequent claim resulting from the Vessel's return to service on the basis that such loss would not result from a fortuitous event
- Zenith renewed coverage and increased premium in 2007, and renewed coverage each year thereafter
- Vessel B failed in 2010 before final repairs were carried out
- Acme operators complained to management that continued operation with temporary repairs was not safe

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The Fortuity Defense

Policyholder's Perspective

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Fortuity – The Test is Substantial Certainty

- Under New York law, a loss is fortuitous unless the insured:
  - Intended the loss, or;
  - Acted, or failed to act, with knowledge that the loss was substantially certain to result
- Courts sometimes express this standard as acting with knowledge that the loss "would flow directly and immediately from the insured's intentional act"
  - *See National Union Fire Ins. Co. of Pittsburgh, PA v. Stroh Cos.*, 265 F.3d 97 (2d Cir. 2001) (citing *City of Johnstown v. Bankers Standard Ins. Co.*, 877 F.2d 1146, 1150 (2d Cir. 1989).
  - Second Circuit rejected insurer's argument that loss was not "fortuitous" because it was not "beyond the control of either party" within the meaning of N.Y. Ins. Law § 1101(a)(2).

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The Test is Certainty, Not Control

- Some courts applying New York law have relied on New York Insurance Law in determining whether losses are fortuitous.
- Section 1101(a) of that statute defines "fortuitous event" as "any occurrence or failure to occur which is, or is assumed by the parties to be, to a substantial extent beyond the control of either party."
  - Section 1101 properly applies to licensure, not coverage
- Test of fortuity is not properly centered around degree of "control" that an insured exercises over the risk, and reliance on Section 1101 to support such an argument is misplaced
- Non-fortuity requires certainty, and neither insured's control of risk, nor even courting of risk, is sufficient to show non-fortuity.

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The Test Is Certainty, Not Control

- Professor Edwin Patterson was an author of NY Insurance Law

"*The Designing Act of the Insured*.

> . . . But to say that the insurer is not liable if the happening of the insured event was within the control of the insured would be erroneous or at least likely to mislead. Unless control means only designedly causing the insured event, a meaning narrower than the ordinary sense of the word, it includes a great many situations in which the insurer is undoubtedly liable. Thus, a defective chimney is "within the control" of the insured, since it can be repaired; yet fires due to defective flues are covered by the ordinary fire policy. Even if control is narrowed to include only situations of which the insured has knowledge, it is still too broad, since an insured who carelessly put off repairing a known defect in his chimney would not thereby be barred from recovering on his fire-insurance policy.

- Patterson, ESSENTIALS OF INSURANCE LAW 257-58 (2d ed. 1957).

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Loss Resulting From Calculated Risk May Still Be Fortuitous

- "It is not enough that an insured was warned that damages might ensue from its actions, or that, once warned, an insured decided to take a calculated risk and proceed as before . . . Recovery will only be barred if the insured intended the damages . . . or if it can be said that the damages were, in a broader sense, 'intended' by the insured because the insured knew that the damages would flow directly and immediately from its intentional act . . . ."
  - *City of Johnston*, 877 F.2d at 1150 (emphasis added; citations omitted).
- Fortuity doctrine does not bar coverage for *likely* losses, i.e., known enhanced risks. "Even if the risk [of the loss that occurred] was known [by the insured], and known to be high," when the coverage at issue was added to the policy, that would not bar coverage. *Id.*
  - *National Union v. Stroh*, *265 F.3d* at 108 (citing *City of Johnstown)*.

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Loss Resulting From Calculated Risk May Still Be Fortuitous

- "A person may engage in behavior that involves a calculated risk without expecting that an accident will occur – in fact, people often seek insurance for just such circumstances . . . ."
  - *Continental Cas. Co. v. Rapid-American Corp.*, 609 N.E.2d 506, 510 (N.Y. 1993)(citing, *inter alia*, *City of Johnstown*)
- Rockslide example:
  - Rockslide, "while a known risk at the time the [all-risks] policies took effect, was not 'substantially certain to occur,'" and was therefore fortuitous, even though:
    - it involved a sixty-ton boulder falling from a hillside above the insured's store;
    - there had been rockslides before policies' inception, including another sixty-ton boulder falling on the store; and
    - the insured was aware of the geologic instability of the hillside
  - *Wal-Mart Stores, Inc. v. United States Fid. & Guar. Co.*, No. 06-4417/2002, 2005 BL 323, *aff'd in relevant part*, 816 N.Y.S.2d 17, 18 (N.Y. App. Div. 2006) (citing *National Union*, *supra*)

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Burden of Proof

- The insured under an all-risks policy has a "relatively light" burden of showing that its loss was fortuitous
  - *Petroterminal De Panama, S.A. v. QBE Marine & Specialty Syndicate 1036,* 2017 U.S. Dist. LEXIS 7638 (S.D.N.Y. Jan. 19, 2017) (quoting *Int'l Multifoods Corp. v. Commercial Union Ins. Co.*, 309 F.3d 76, 83 (2d Cir. 2002)); *see also Fleet Business Credit, L.L.C. v. Global Aerospace Underwriting*, 812 F. Supp. 2d 342, 354 (S.D.N.Y. 2011).
- Once insured meets that burden, burden shifts to insurer to prove otherwise
- In *National Union*, Second Circuit held that "[t]he initial burden of showing that the loss in question was fortuitous – here meaning that the inevitability of such loss was not known to the insured before coverage took effect – is on the insured party . . . Once that burden is met, the insurer must come forward with evidence showing that 'an exception to coverage applies,' including exceptions based on the non-fortuity or known loss doctrines." *National Union*, 265 F.3d at 109 (citations omitted).

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Applying the Certainty Standard To Hypothetical Scenarios

- Under any of the three scenarios:
  - Absurd to suggest that Acme would knowingly cause an explosion that destroys its property, interrupts its business, and threatens the lives of its employees, including the employees responsible for Acme's mechanical integrity program

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Applying the Certainty Standard To Hypothetical Scenarios

- The industry standards (curves) are developed from industry experience and adjusted over time to reflect new reports of corrosion
- At time of loss, Acme's mechanical integrity program in full compliance with recognized and generally accepted good engineering practices (RAGAGEP) in regard to the vessels
  - After incident, industry standards altered to be more protective
- Acme's mechanical integrity program also in compliance with Acme's own internal inspection practices, which exceeded the requirements of RAGAGEP
- Acme engaged third-party corrosion experts to evaluate the equipment
  - Acme personnel lacked expertise to evaluate all equipment for every potential damage mechanism
  - Acme retained and relied on third parties with superior expertise

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Applying the Certainty Standard To Hypothetical Scenarios

- Scenario A:
  - Acme did not know of the damage that caused the loss
  - That is enough to show that Acme did not know that an explosion would occur
  - Even accepting, in hindsight, that Acme could have discovered the damage does not mean that Acme knew that it was substantially certain that an explosion would occur
- Scenario B:
  - Acme knew of the damage, but thought it was repaired
  - Simply choosing least expensive, and in hindsight, inadequate repair alternative does not mean that Acme knew that it was substantially certain that an explosion would occur

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Applying the Certainty Standard To Hypothetical Scenarios

- Scenario C:
  - Warning letters mentioned "risk" of catastrophic failure or explosion, but did not opine on how likely or how soon
  - So long as failure was a mere risk, even if a heightened risk, it remained insurable
  - Insurer explicitly took into account the possibility of catastrophic failure, and increased premium to account for it, and renewed year after year
    - Letter "reserving the right" to deny claims is not a part of the policy
    - The policy governs the claim, and insurer cannot unilaterally modify policy

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The Fortuity Defense

Insurer's Perspective

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The Starting Point

Fortuity is a required element of policies based on an **"accident"** or **"occurrence"**.

Consol. Edison Co. of N.Y., Inc. v. Allstate Ins. Co., 98 N.Y.2d 208, 220 (N.Y.2002)

Under an all-risk policy, the insured's prima facie case must establish (i) policy existence; (ii) insurable interest; and (iii) **fortuitous loss, i.e., an event happening by chance or accident.**

40 Gardenville, LLC v. Travelers Prop. Cas. of Am., 387 F. Supp. 2d 205, 211 (W.D.N.Y. 2005)

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Why Have the Requirement

In an insurance contract, the parties are making a wager as to the likelihood that a specified loss will occur. If the loss has already occurred, or the insured knows it is certain to occur for undisclosed reasons, then the contract is not a fair bet.

CPH Int'l, Inc. v. Phoenix Assur. Co. of N.Y., No. 92 Civ. 2729 (SS)(NRB), 1994 WL 259810, at *6 (S.D.N.Y. June 9, 1994)

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The Building Blocks for the Defense

New York Ins. Law § 1101: Fortuitous event is an occurrence which is to a substantial extent beyond the **control** of the parties.

Key Component: Insured's Control

Newtown Creek Towing Co. v. Aetna Ins. Co., 57 N.E. 302 (N.Y. 1900): While the insured hoped the vessel would not strike the ice that was all around, he admittedly could not see the ice at night, but proceeded anyway heedless of the risk.

Key Component: Insured's Causative Conduct

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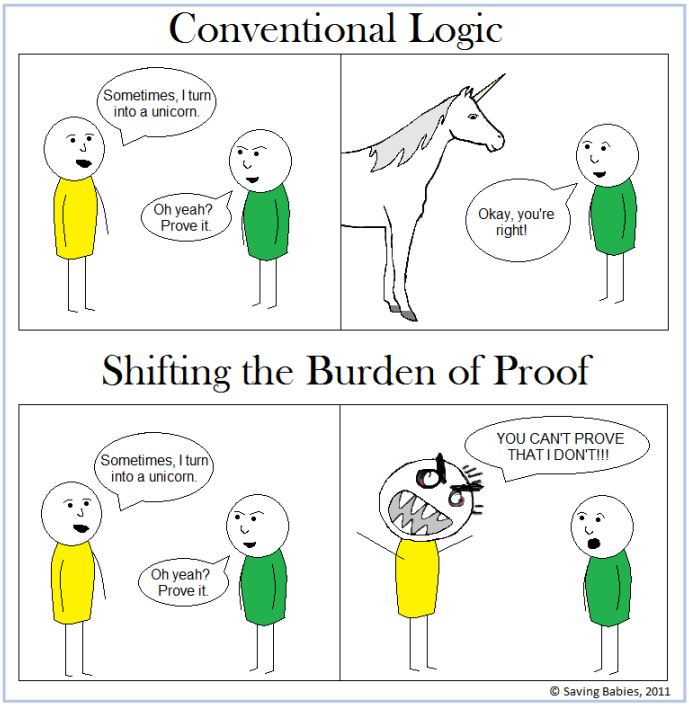
The Burden of Proof



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Catastrophic Loss – Burden of Proof Reality

- Legally – the insured must prove the loss was caused by a fortuitous event, meaning an event happening by chance or accident
- Practically – the insurer must present substantial evidence of the insured's control and causative misconduct
- The insurer must disprove the event was an accident or occurrence by showing the loss was known, planned, intended, or substantially certain to occur

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Meeting the Burden – Critical Fact Development

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Retained Experts Must Analyze

- The maintenance, inspection, and operational history of the equipment
- The cause(s) of the equipment failure
- The insured's non-compliance with controlling internal and industry standards
- The insured's heightened knowledge of the risks or dangers involved
- The insured's deliberate misconduct leading to the loss

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The Immediate Goal – Avoiding Summary Judgment

The denial of summary judgment interjects substantial financial risk for the insured.

The insurer must make the case that a jury could reasonably find that the insured's intentional acts prevent the loss from being attributable to mere chance.

Royal Indem. Co. v. Deep Sea Int'l, 619 F.Supp.2d 14, 22-23 (S.D.N.Y. 2014) (insured's summary judgment on fortuity defense denied where vessel repair was knowingly made in violation of applicable standards and caused ship to sink).

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Now, Turning to Acme . . .

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A Significant Hurdle

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Flying Blind = Intentional Misconduct

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Points to Consider

- Is the collision with the wall an accident
- Is the collision substantially within the insured's control
- Is the decision to fly blindfolded intentional misconduct of the type necessary to prove non-fortuity

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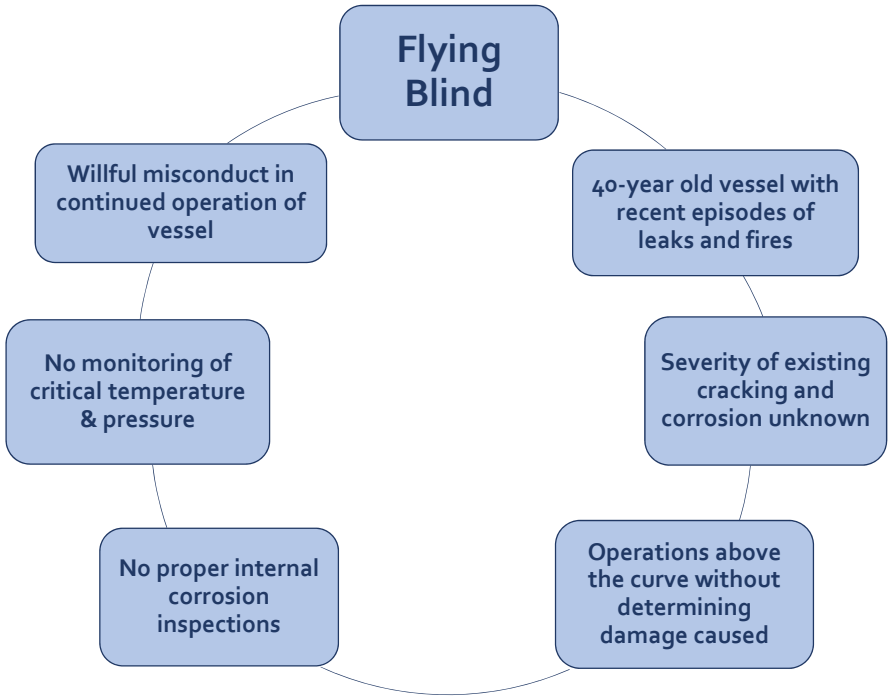
Acme's Decision to Fly Blind



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Deliberate Risk Taking with Known Danger

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Substantial Certainty

- Insurance is not available for loss the insured knows of, planned, intended or is aware is substantially certain to occur
- When the rope burns in half, and the fall occurs, is that fortuitous
- Does continuing the rope walk in the face of known danger with the expectation that a fall will not occur constitute intentional misconduct sufficient to render the fall non-fortuitous

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Applying the Example to Acme's Misconduct

- Deliberately courted known risks to property and personnel – **unacceptable**
- Continued vessel operation with history of fires and volatile leaks without repair – **unacceptable**
- Implemented "accelerated" start-up procedures from 12 hours to 2 hours to mitigate the fires and leaks – **unacceptable**
- Continued vessel operation above the curve in the known danger zone – **unacceptable**
- Failed to know vessel's operating temperatures and pressures; instead assuming these key parameters remained safe – **unacceptable**

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Case Recap

***In re Margulies*, No. 16 Civ. 2643 (KPF), 2017 WL 1049548 (S.D.N.Y. Mar. 20, 2017)**

No coverage for damages caused by insured driver who hit traffic director. "[T]he incident was not 'to a substantial extent beyond the control of either party.' [Insured] was in control of his car, had the capacity to use his brakes, and chose not to do so. The situation was well within his capacity to avoid."

***Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Turner Constr. Co.*, 986 N.Y.S.2d 74 (N.Y. App. Div. 2014)**

"[T]he requirement of a fortuitous loss is a necessary element of insurance policies based on either an 'accident' or 'occurrence.' . . . [A] claim for faulty workmanship, in and of itself, is not an occurrence . . . because a failure of workmanship does not involve the fortuity required to constitute an accident."

***Highland Capital Mgmt., L.P. v. Glob. Aerospace Managers Ltd.*, 488 Fed. App'x 473, 475-76 (2d Cir. 2012)**

All risk policy covering "direct and accidental physical loss" to aircraft did not cover any co-insureds' claims because "airframe and engine losses . . . were caused by the intentional misconduct of plaintiffs' coninsured" who removed airplane parts after company's bankruptcy and thus "the damage was not fortuitous."

***Royal Indem. Co. v. Deep Sea Int'l*, 619 F. Supp. 2d 14, 22-23 (S.D.N.Y. 2007)**

"[T]here is a factual issue as to whether Deep Sea properly repaired the vessel . . . . If the jury credited Royal's evidence, it could reasonably find that Deep Sea intentionally chose inadequate methods to repair the Aloha, despite being aware that those methods violated the standards required of Panamanian-flagged ships. The jury could then find Deep Sea's actions to be intentional misconduct even in the absence of outright fraud. Deep Sea is therefore not entitled to summary judgment with respect to the fortuitous nature of the loss of the scientific equipment."

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"You Screwed Up: You Trusted Us! Conflicts Among Insurers, Independent Counsel and Insureds."

ACCEC Annual Meeting
Chicago, May, 2017

Marion B. Adler – William T. Barker – Doug McIntosh – Neil Posner

Panel Discussion — "Friction Points"

Billing Rates: Insurer has agreed to accept insured's defense under a reservation of rights that, under applicable law, give the insured the right to be defended by independent counsel of insured's choosing. Insured wants to use one of its regular "Big Law" or "Sophisticated Litigation Boutique" firms to defend. This firm charges "premium" rates. Insurer, recognizing that applicable law requires it to relinquish control of the defense and discharge its defense obligations by reimbursing the insured for the reasonable costs of defense, wants to cap its reimbursement obligation at the highest rate the insurer pays panel counsel.

I. What Rules are at issue here?
II. Any other law?

"National vs. Local Counsel"

Insured has been sued in multiple jurisdictions for a substantially similar injury. Insured gave timely notice and tender to its insurer, which accepted the defense of these lawsuits without a reservation, and appointed defense counsel in each jurisdiction. This is the type of action, however, that the insured fears is the type of suit that gives rise to similar or "copycat" types of lawsuits. As a result of this concern, insured has retained "national coordinating counsel" to oversee the defense of these lawsuits, and wants insurer to pay for the cost of such national coordinating counsel. Insurer believes it has discharged its duties by providing local counsel in each jurisdiction. Insured feels that a coordinated defense could serve to reduce the risk of similar lawsuits in other jurisdictions, and might save money with respect to these current lawsuits.

I. What Rules are at issue here?
II. Any other law?

When "Independent" Counsel becomes "Panel" Counsel

I. Insured is covered under a CGL policy, which comes with the usual "form" exclusions and a few additional ones based on underwriting concerns. Insured is sued; gives timely notice and tender to insurer. Insurer disclaims coverage for defense and indemnity based on one of those endorsed exclusions and several of the form exclusions, and files a Declaratory Judgment action.
II. Insured hires its usual law firm, Stifle & Blote to handle the case, which is in a jurisdiction in which S&B does not have an office. S&B then hires Goode & Plenti as local counsel. Both firms charge rates that are approximately twice what the insurer's panel counsel charge in those jurisdictions. In those jurisdictions, the insurer's panel law firms have lawyers qualified to handle the insured's case.

When "Independent" Counsel becomes "Panel" Counsel

IV. One of the current firms that has been defending the underlying case for the last four years actually is an approved panel firm, and for files sent to the firm by the insurer, charges half the rate they charge for outside cases.

V. The insurer agrees to pay the higher rate both back to the date of notice and going forward, subject to a reservation of rights to recover the all costs and fees if it turns out coverage is denied to the insured on one of the reserved exclusions.

When "Independent" Counsel becomes "Panel" Counsel

Ethics Questions:

1. Does the panel firm have an obligation to reveal to its client its "preferred" rate it charges to the insurer? If so, did it have this obligation at the beginning of the engagement? Or only now that the court has ruled in the insured's favor?

When "Independent" Counsel becomes "Panel" Counsel

Ethics Questions:

2. Does the panel firm have an obligation to offer the insurer the lower rate on a going forward basis, given the risk that the insured-client may have to reimburse the insurer if the case results in liability based on excluded conduct?

When "Independent" Counsel becomes "Panel" Counsel

Ethics Questions:

3. What Rules, other law, are implicated here?

What Information is Insurer Entitled To?

I. Situation I: Reservation of Rights; Independent Counsel

1. Insurer issued reservation of rights that, under applicable law, give insured right to select independent counsel.
2. Insurer relinquishes control of the defense but, regardless, asserts right to be informed of defense strategy and defense counsel's assessment of liability. Insurer argues that, since it may eventually have to pay, it has a need to know what it may be in for, so it can appropriately set reserves, and because it ultimately may have to write out a big check.
3. Insured instructs defense counsel not to share any of this with insurer, given that insurer, by virtue of its ROR, already has indicated a desire to avoid payment.
4. What Rules, other law, are implicated here?

What Information is Insurer Entitled To?

II. Situation II: No Reservation of Rights; Insurer-Appointed Counsel

1. Even though insurer is providing a defense without a reservation of rights, through discovery and discussions with the insured client defense counsel learns of facts that, if provided to the insurer, may give the insurer grounds to deny coverage.
2. What Rules, other law, are implicated here?

Litigation Management & Billing Guidelines

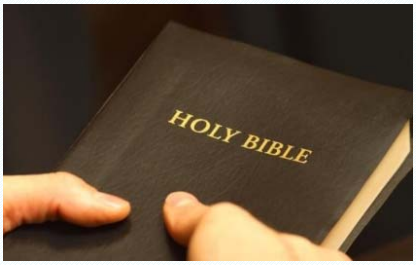
I. Insurer has accepted defense under a reservation of rights. Under applicable law, insured has the right to select independent counsel, and does. Insurer sends its standard Litigation Management & Billing Guidelines to independent counsel, with a cover letter explaining that insurer expects counsel to agree to these and to not deviate from them without insurer's written consent. The LM&BG document includes the following limitations:

Litigation Management & Billing Guidelines

1. Counsel must seek advance permission of insurer to conduct any legal research that will take more than 5 hours.
2. Time entries for interoffice conferences among lawyers and/or legal assistants will be disallowed.
3. No more than one lawyer may attend a court proceeding, deposition, or other meeting.
4. Counsel must seek advance permission of insurer to engage consultants and experts.
5. Counsel must seek advance permission of insurer for out-of-town travel.
6. Counsel must submit a detailed litigation budget within 60 days of being retained or 30 days of filing the Answer or first responsive pleading, whichever comes first.
7. Counsel must submit status reports no less frequently than every 90 days.
8. Dispositive pleadings (but not routine motions) are to be submitted to insurer 5 days prior to due date.
9. "Block billing" will be disallowed; every task must be entered in a separate billing entry, in 0.1 hour increments, and ABA task codes must be used. All bills to be submitted through insurer's electronic billing system. Bills must be submitted monthly; will be paid quarterly.
10. Bills for that which insurer regards as overhead will be disallowed, such as postage, copies, fax, messengers, local transportation, and Westlaw & Lexis.

Litigation Management & Billing Guidelines

II. What Rules, other law, are implicated here?



Defense Counsel or Coverage Counsel?

I. Insured is sued in an environmental case. Insured gives timely notice and tender to insurer, which accepts the defense under a reservation of rights, which, under applicable law, gives insured the right to independent counsel. Insured retains the law firm of Monte & Piethon to defend. After about a year, the insurer reaches the conclusion that there is no basis upon which liability can be found that would not be excluded by the policy, and files a Declaratory Judgment action against insured. Insured, which believes that the insurer is wrong, asks defense counsel to defend the DJ. The lead partner on the case, Bradley Straightarrow, runs the request through the firm's conflict-checking system, and gets "push back" from a partner in one of the firm's other offices; that partner does a lot of corporate work for that insurer, and doesn't want to rock the boat by asking for a conflict waiver. The firm declines the engagement.

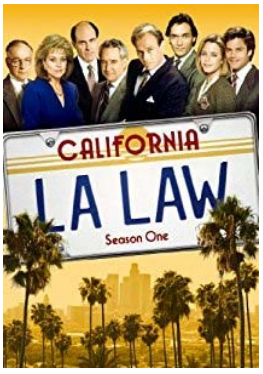
II. Bradley, at client's request, refers the DJ matter to another law firm, Mayke Mai & Day, LLP, which specializes in policyholder-side coverage. MM&D's partner, Ann-Marie Marianne, asks Bradley for assistance in preparing to defend the DJ. Bradley, believing that he owes his client a duty to provide coverage counsel with the requested assistance, complies.

Defense Counsel or Coverage Counsel?

III. Bradley's "other office" partner--the one who pushed back and refused to ask his insurer-client for a waiver--pitches a fit and threatens to report Bradley to the State Bar Disciplinary Commission. Freaked out, Bradley goes to his firm's in-house Ethics & Professional Responsibility counsel for advice.

IV. In this case, may defense counsel play a role in coverage? If not in this case, in any case?

V. What Rules, other law, are implicated here?



Fifteen Cases in Forty-Five Minutes: The Most Important Coverage and Extracontractual Decisions of the Past Year

2017 Annual Meeting
May 11-12, 2017
Chicago, IL
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1. Late Notice

Templo Fuente de Vida Corp. v. National Union Fire Insurance Co., 224 N.J. 189 (2016)

- Claims-Made D&O policy
- Policyholder gave notice within policy period
- Policy required notice 'as soon as practicable'
- Unexplained six month delay in providing notice
- No coverage

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2. What is a Claim?

S.M.Electric Company, Inc. v. Torcon, Inc., 2016 N.J. Super. Unpub. LEXIS 2289 (N.J. App. Div. 2016)

- Torcon – construction manager
- SME – contractor
- Claims-made policy
- SME sent letter to Torcon in 2008 entitled "A Request for Equitable Adjustment," seeking $15,337,068, "as compensation for the additional cost of performing the work." Torcon did not give notice to its insurance company.
- SME sued Torcon in 2010. Torcon provided notice to its insurance company.
- Court – 2008 letter was a claim. Late notice barred the claim.

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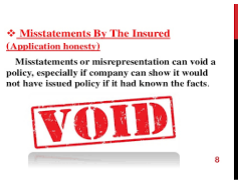
3. Misrepresentation on Application

H.J. Heinz Co. V. Starr Surplus Lines Ins. Co., 2017 U.S. App. Lexis 510 (3d Cir. 2017)

- Multi-million dollar claim for contaminated baby food in China
- Court found that Heinz' risk manager had deliberately failed to list prior losses in order to obtain lower SIR
- Policy rescinded
- No waiver by insurance company due to possible knowledge of unreported losses from extraneous sources.



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4. Construction Defects Insurance

Cypress Point Condominium Assn. v. Adria Towers, 226 N.J. 403 (2016)

National Surety Corp. v. Westlake Investments, LLC, 880 N.W. 2d (Iowa 2016)

- Both cases addressed insurance coverage under general liability policies for construction defects.
- Both found coverage
- Subcontractor errors were accidental and an occurrence
- Subcontractor exception to your work exclusion applies
- Cypress – "consequential damages caused by the subcontractors faulty workmanship – is an 'occurrence' under the plain language of the CGL policies at issue here"
- National Surety – "Whether an event amounts to an accident that constitutes an occurrence triggering coverage under a modern standard-form CGL policy turns on whether the event itself and the resulting harm were both 'expected or intended from the standpoint of the insured.'"

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5 Property Damage

Phibro v. National Union Fire Insurance Company, 446 N.J. Super. 419 (App. Div. 2016)

- Feed additive in chicken feed caused chickens not to gain weight – chickens were wrong size for processors
- Court – change in chickens' physical condition constituted property damage under general liability policy

Also, loss of use

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6. Data Breach

Travelers Indem. Co. v Portal Healthcare, 2016 U.S.App. LEXIS 6554 (4th Cir. 2016)

- Medical records on web – no evidence that anyone viewed them
- Insurance company – no publication
- Court – "Publication" does not hinge on third party access, but occurs when information is placed before the public
- Now – most liability policies have massive data breach exclusions

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7. Cyber-insurance

P.F. Chang's v. Federal Insurance Co., 2016 U.S. Dist. Lexis 70749 (D. Ariz. 2016).

- Data breach on cyber-insurance policy
- P.F. Chang's had contract with servicer to manage credit card transactions. That servicer had contract with bank.
- Because of data breach, bank incurred charges, which it passed on to servicer, servicer passed on to P.F. Chang's.
- No insurance coverage – contract exclusion
- Carefully draft cyber-insurance policies

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8. Cyber II

Apache Corp. v. Great American Ins. Co., No. 15-20499 (5th Cir. Oct. 18, 2016)

- Computer fraud provision of crime protection insurance policy – "We will pay for loss…resulting directly from the use of any computer to fraudulently cause a transfer…."
- "authorized payments of legitimate invoices from its vendor to the criminals' bank account…."
- Trial court found coverage – Fifth Circuit reversed
- Criminals sent email on vendor's letterhead with old and new bank account numbers.
- Apache called phone number on letterhead to confirm and then approved change and sent money to false bank account.
- Fifth Circuit found that use of computer was not direct cause of loss – use of email was "merely in- cidental" – every fraud that uses email is not a computer fraud

See also, Taylor & Lieberman v. Federal Insurance Company, no. 15-56102 (9th Cir. 2017)

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9. Number of Occurrences

Selective Ins. Co. of Am. v. County of Rensselaer, 26 N.Y.3d 649 (2016)

- Class action against County for strip searches of prisoners
- Policies had a per occurrence deductible
- Court – each individual class member is a separate occurrence to which a separate deductible applied
- When settlement was prorated among individual class members, each individual's share was within deductible
- Solutions – batch clauses, aggregating clauses, aggregate deductible

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10. Reservation of Rights

Harleysville Group Insurance v. Heritage Communities, No. 27698 (S. Car. 2017)

- "Harleysville's efforts to reserve its rights were generic statements of potential non-coverage coupled with…copies (through a cut-and-paste method) of the insurance policies."
- Insurance company defended under reservation of rights.
- Court found ROR letter to be ineffective: "It is axiomatic that an insured must be provided sufficient information to understand the reasons the insurer believes the policy may not provide coverage."

Reservations about Reservation of Rights

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11. Ambiguity

St. Paul Mercury Ins. Co. v. Federal Deposit Ins. Corp., No. 14-56830 (9th Cir. 2016)

1. If insurance company had intended exclusion to have broad application, should have used broader language, such as "based upon, arising out of, attributable."

If insurance company and policyholder both present reasonable interpretations, policyholder wins.

2. 'Insured v. Insured' exclusion ambiguous "as applied to FDIC as receiver."

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12. Settlement

J.PMorgan Securities Inc. v. Vigilant Ins. Co., No. 600979/09 (N.Y. Sup. 2016)

- Insurance policy – policyholder can't settle without insurance company's consent. Under NY law, policyholder could settle if insurance company denied coverage.
- Insurance companies sent numerous letters over many years giving reasons why coverage did not exist, but ended each letter by stating that it was dependent on further information.
- Policyholder settled without insurance company's consent
- Insurance companies: we never denied coverage, so settlement isn't covered
- Court – insurance companies effectively denied coverage.

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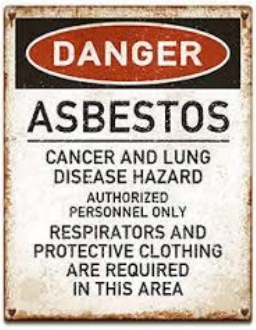
13. Continuous Trigger, not injury in fact

a. Trigger theory adopted as matter of law, without need for expert medical testimony
   i. Rejected insurer arguments that current medical understanding of asbestos diseases is not compatible with prevailing trigger theories.



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13. Pro-rata allocation

a. Adopts "unavailability of insurance rule"
   i. Leave door open for equitable exception
   ii. Claims made years coverage only to be included for claims that meet the policy's claim made trigger; otherwise, claims made coverage is not considered as "available"
   iii. Compare with Keyspan in NY, declining to apply Unavailability Rule and Honeywell in NJ, rejecting equitable exception
b. Default DOFE for claims without a known DOFE
   i. Rejected fixed 1962 or 1948 default DOFE; remanded for further proceedings to determine default DOFE method reflecting actual latency periods
c. Affirmed exhaustion of primary policies based on payments made under allocation agreement between primary insurers, even though agreement used shorter allocation block than court ultimately adopted.

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13. Duty to Defend

a. No duty to defend under excess coverage in umbrella/excess policies

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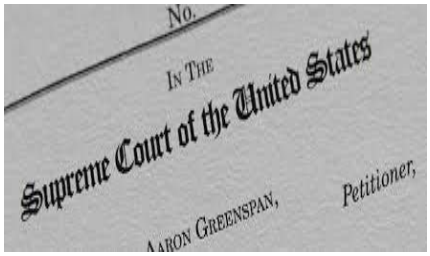
13. Petitions to CT Supreme Court Due April 26



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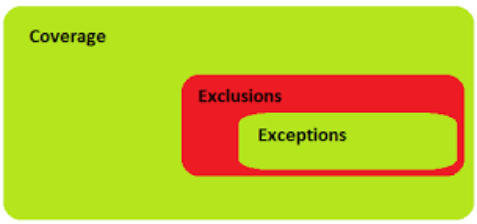
13. Exclusions

a. Absolute and qualified pollution exclusions apply only to "traditional environmental pollution" and not to indoor asbestos exposures.

b. Occupational disease exclusion not limited to insureds' employees



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14. Damages "Because of" Bodily Injury

Cincinnati Ins. Co. v. H.D. Smith, L.L.C., 829 F.3d 771 (7th Cir., 2016)

- "Pill Mill" Case
- West Virginia sues pharma distributors, alleging:
  - Pharmacies knowingly provide addictive drugs to fuel citizens' addictions;
  - Distributors should know from quantities supplied that drugs would be used for illicit, destructive purposes;
  - State spends hundreds of millions of dollars annually treating residents' drug-related injuries.
- CGL policy covers "damages **because** of bodily injury."

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14. Damages "Because of" Bodily Injury (cont'd)

- "**Bodily injury**" means "bodily injury, sickness or disease **sustained by a person**…"
- "**Damages because of bodily injury**" include "**damages claimed by any person or organization for care….resulting at any time from the bodily injury**."
- District court grants insurer's MSJ: Suit does not allege damages because of bodily injury.
- Insurer: State seeks own damages, not damages on behalf of its citizens.
- 7th Circuit: "[S]o what?" Insurer's argument "untethered to any language in the policy."
- Carrier must defend.

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15. ABSOLUTE POLLUTION EXCLUSION

Colony Insurance Co. v. Victory Construction, 3:16-cv-00457 (D. Or. 2017)

- Failure to install properly a swimming pool heater led to release of carbon monoxide; several people sickened
- No coverage – carbon monoxide is a pollutant

The Doe Run Resources Corporation v. American Guarantee & Liability Insurance Co., et al., 10SL-CC01716 (Mo. Ct. App. 2016)

- Lead pollutants arising from smelting operation- covered
- Exclusion is ambiguous, coverage for policyholder's operations

Castoro & Co. v. Hartford Acc. & Ind. Co., et al., Civil Action No. 14-1305 (MAS)(DEA) (D.N.J. 2016), on reconsideration, (D.N.J. 2017)

- Absolute Pollution Exclusion only applies to traditional, intentional pollution

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Thank You

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