

PUSHING THE BOUNDARIES OF D&O ENTITY COVERAGE

ENTITY INVESTIGATION
COSTS COVERAGE

Dan Bailey
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COVERAGE FOR CONSUMER
AND SIMILAR NON-FIDUCIARY
CLAIMS

Marion B. Adler
Rachlis Duff Adler Peel & Kaplan,
LLC

Coverage for Consumer & Similar Non-Fiduciary Claims under D&O Policies

- D&O or “Management Liability” Coverage Part
- Other Coverage Parts packaged with D&O Coverage provide important supplemental coverage
 - Employment Practices Liability
 - Fiduciary Liability – ERISA/ Employment Benefits claims
 - Cyber Coverage
- “Entity” Coverage – “Side B” – For the Company, not individual Officers and Directors

Focus Here is Privately Held Entities

- Entity Coverage for Publicly Held Entities is Generally More Restrictive
- Limited to Coverage against the Entity for Claims brought by “Security Holders” for violation of securities law in sale or purchase of securities

Consumer Protection Claims

- *24 Hour Fitness USA, Inc. v. National Union Fire Ins. Co.*, CV 11-8088-GHK (RZx) Mem. Op. at 10-11 (C.D. Cal. March 21, 2013): allegedly misleading statements induced plaintiff class to enter into gym memberships
- *Integra Telecom, Inc. v. Twin City Fire Ins. Co.*, Civ. No. 08-906-AA, 2010 WL 1753210 (D. Or. Apr. 29, 2010): claims under state consumer protection statute for overbilling of customers

Real Estate and Construction Disputes

- *Corky McMillin Constr. Svc., Inc. v. U.S. Specialty Ins. Co.*, 597 Fed. Appx. 925 (9th Cir. 2015): class action claims by home buyers against real estate broker for misrepresentations and omissions in marketing material
- *S.J. Amoroso Constr. Co. v. Exec. Risk Indem., Inc.*, 325 Fed. Appx. 548, 2009 WL 1154202 (9th Cir. Apr. 30, 2009): misrepresentations by construction company that induced developer to consent to assignment of construction contract

Claims by Investors

- *Great Amer. Ins. Co. v. Geostar Corp.*, No. 09-123888-BC, 2010 WL 845953 (E.D. Mich. Mar. 5, 2010): investors in tax-advantaged mare-lease program
- *Westchester Fire Ins. Co. v. Rosenthal Collins Group, LLC*, No. 2013 CH 01508 (Ill. Cir. Ct. Cook Cty. July 3, 2014), *vac'd by settlement* (Jan. 12, 2015): investors' claims against futures commission merchant that cleared trades of self-dealing financial advisor who squandered investors' funds

Broadly Worded Insuring Agreement

Challenging Exclusions

Insuring Agreement

This **D&O Coverage Section** shall pay the **Loss** of the **Company** arising from a:

(i) Claim made against the **Company**,

...

for any **Wrongful Act**

(AIG 2007 Form)

Definition of Loss

“**Loss**” means damages, judgments, settlements, pre-judgment and post-judgment interest, ... and **Defense Costs**; ... **Defense Costs** shall be provided for items specifically excluded from **Loss** pursuant to ... this Definition, subject to the other terms, conditions and exclusions of this policy.

Loss shall specifically include, subject to the other terms, conditions and exclusions of this **D&O Coverage Section**, including, but not limited to, exclusions 4(a), 4(b) and 4(c) ..., punitive, exemplary and multiple damages The enforceability of the first sentence of this paragraph shall be governed by such applicable law which most favors coverage for punitive, exemplary and multiple damages.

By definition “Loss” does not include

- (i) civil or criminal fines or penalties imposed by law;
- (ii) taxes;
- (iii) any amounts for which an **Insured** is not financially liable or which are without legal recourse to an **Insured**; or
- (iv) matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed.

Definition of “Claim”

(i) a written demand for monetary or non-monetary relief (including any request to toll or waive any statute of limitations);

(ii) a civil, criminal, administrative, regulatory or arbitration proceeding for monetary or non-monetary relief which is commenced by:

(1) service of a complaint or similar pleading;

(2) return of an indictment, information or similar document (in the case of a criminal proceeding); or

(3) receipt or filing of a notice of charges

Definition of “Wrongful Act”

any breach of duty, neglect, error,
misstatement, misleading statement,
omission or act by a **Company**

“Wrongful Act” is Not limited to Negligent or Inadvertent Conduct.

It includes deliberate misconduct and omissions – even criminal misconduct.

Exclusions

- Contractual Liability Exclusion
- Anti-Trust & “Unfair Trade Practices” Exclusion
- Professional Services Exclusion
- Exclusion for Gaining any “Unfair Profit or Advantage”

Contractual liability exclusion bars coverage for claims ...

alleging, arising out of, based upon or attributable to any actual or alleged contractual liability of the **Company** or any other **Insured** under any express contract or agreement; provided, however, this exclusion shall not apply to liability which would have attached in the absence of such express contract or agreement.

Contractual liability exclusion may be significant impediment to coverage for claims by customers or others in contractual privity.

Fed. Ins. Co. v. KDW Restr. & Liq. Svc., LLC, 889 F. Supp. 2d 694, 708 (M.D. Pa. 2012): misrepresentation claims by mini-mart purchasers against seller barred, although not sounding in “contract,” because claims were “based upon, arising from, or in consequence of any actual or alleged liability under the contracts.”

Medill v. Westport Ins. Corp., 143 Cal. App. 4th 819, 49 Cal. Rptr. 3d 570 (2006): bondholder claims against defaulting issuer barred by exclusion because the parties’ relationship was contractual in nature, even though underlying suit asserted claims sounding in tort, not breach of contract.

However, some courts have held that the exclusion is inapplicable where ...

Claim is based on pre-contractual dealings between customer & insured.

- *24 Hour Fitness* – although some claims were barred because they were based on allegations that insured's electronic transfer of funds exceeded insured's contractual rights, claims that alleged pre-contractual misrepresentations induced plaintiffs to purchase gym memberships were not barred.
- *Cousins* – although exclusion barred all post-contractual damages incurred by franchisees, it but did not bar coverage for damages incurred before they entered in franchise agreements.

Other courts have held that Exclusion is inapplicable where ...

Contractual relationship does not run between the insured and the underlying plaintiff but rather is with some other party

- *S.J. Amoroso* – Where underlying plaintiff’s theory of insured’s liability in underlying case was dependent “on the fact that Amoroso was not a party to the construction contract ... Amoroso’s liability is not liability under a contract or agreement,” and therefore exclusion inapplicable.
- *Lifespan Corp* - Claims brought by state AG against hospital for breaching fiduciary duties in negotiating insurance contracts for its subsidiaries were not barred by contractual liability exclusion because hospital and AG had no contractual relationship.

Anti-Trust & Unfair Trade Practices Exclusion

Bars coverage for claims

for any actual or alleged violation of any law, whether statutory, regulatory or common law, respecting any of the following activities: anti-trust, business competition, *unfair trade practices* or tortious interference in another's business or contractual relationships.

Not in all policies. In AIG standard form; not ACE or Chubb.

Despite reference to “unfair trade practices,” courts apply doctrine of *noscitur a sociis* to limit exclusion to claims of anti-competitive behavior

- *24 Hour Fitness*
- *Integra*
- *Cousins*

Professional liability exclusion bars coverage for claims

based upon, arising from, or in consequence of performing or the failure to perform any professional service; provided this Exclusion ... shall not apply to any **Claim** brought by or on behalf of a securityholder of the **Organization** in his or her capacity as such.

(Chubb form. Not included in AIG or ACE jacket.)

Exception at end for “securityholder” claims mirrors scope of typical entity coverage for publicly-held entities

Professional services typically are not defined in policy.

Case law typically reads “professional services” as “not limited to services performed by persons who must be licensed by a governmental authority in order to practice their professions. Rather, it refers to *any business activity conducted by the insured which involves specialized knowledge, labor, or skill, and is predominantly mental or intellectual as opposed to physical or manual in nature.*”

An overbroad reading of Professional Services Exclusion may gut the Entity Coverage of a D&O Policy.

The nature of all D&O claims are “predominantly mental or intellectual as opposed to physical or manual in nature.”

Courts have applied a more restrictive reading of Professional Services Exclusions in D&O policies, compared to CGL policies:

- *Geostar*
- *Prosper Marketplace*
- *Hawaiian Electric Industries*
- *Rosenthal Collins*

Unfair gain or profit exclusion

Excludes coverage for a claim

“ arising out of, based upon or attributable to the gaining of any profit or advantage to which any final adjudication establishes the **Insured** was not legally entitled.”

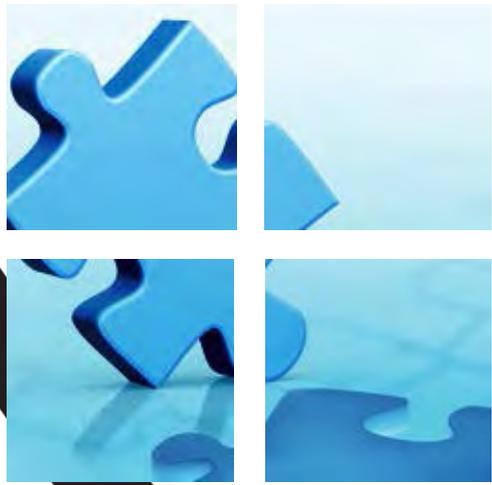
Insurer may use exclusion to deny coverage for claims seeking refunds of payments.

Only applies where “final adjudication” establishes exclusion applies.

Doesn't defeat right to coverage for defense costs

D&O Insurance is Written on Claims-Made Basis

- Stringent Notice Requirements – Claim must be made and “reported” to Insured during the Policy Period (or short time after end of policy period)
- “Related Claims” are deemed a single “claim” that took place as of time that first “claim” was “made” – affects policy limits and notice
- Defense erodes policy limits
- Insurer generally only is required to pay defense costs rather than a “duty to defend”
- Policy language may require allocation of defense costs between covered and uncovered claims.



Cyber Liability

American College of Coverage
and Extracontractual Counsel
Annual Meeting

Sheraton Grand Chicago
Thursday, May 5, 2016
9:50 – 10:40 am



Presenter:

Robert D. Chesler

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Disclaimer

The views expressed by the participants in this program are not those of the participants' employers, their clients, or any other organization. The opinions expressed do not constitute legal advice, or risk management advice. The views discussed are for educational purposes only, and provided only for use during this session.

FTC v. Wyndham

- FTC v. Wyndham – Third Circuit holds that FTC has jurisdiction over data breaches. Privacy policy must be consistent with actual privacy network. Otherwise, the company is in violation of FTC regulations.

Insurance – Legacy Policies

Card issuer complaints, like the Amended Class Action Complaint in the Target litigation, typically allege damages because of the need to replace physical, tangible payment cards. The complaints may also allege that the issuers have suffered damages because of a decrease or cessation in the card usage.

Zurich Am. Ins. Co. v. Sony Corp. of Am., Index No. 651982/2011, 2014 N.Y. Misc. LEXIS 5141 (N.Y. App. Div. Feb. 24, 2014)

- Sony argued for partial summary judgment on duty to defend
- Insurance companies argued no publication
- Insurance companies won
- “Publication” requires an affirmative act by the policyholder. Data breach does not involve an act by the insured – no publication
- Has already been argued on appeal in NY. Case has settled

Recall Total Info. Mgmt. v. Federal Ins. Co., 83 A.3d 664 (Conn. App. Ct. 2014), aff'd, Conn. Supreme Court

- 130 IBM computer tapes fell off a truck - contained sensitive personal information
 - Tapes were never recovered - no evidence that tapes were published or accessed
- Recall Management Loss - \$6,000,000
- No publication because no access to information

Insurance – Legacy Policies

Portal Healthcare

Travelers Indem. Co. v. Portal Healthcare Solutions, LLC (E.D. Va. 2014), *aff'd* No. 14-1944 (4th Cir., April 11, 2016)

“Publication occurs when information is ‘**placed before the public,**’ not when a member of the public reads the information placed before it. By Travelers’ logic, a book that is bound and placed **on the shelves of Barnes & Noble** is not ‘published’ until a customer takes the book off the shelf and reads it. . . . [This] does not comport with the term’s plain meaning, and the medical records were published the moment they became accessible to the public via an online search.”

Hartford Cas. Ins. Co. v. Corcino, CV 13-3728, 2013 U.S. Dist. LEXIS 152836 (Cal. Dist. Ct. App. Oct. 7, 2013)

- Posting medical information on public website
- No coverage for right of privacy created by law
- Coverage – common law right to privacy

Cyber Exclusion – for violating any statute or regulation that “addresses or applies to the sending, transmitting or communicating of any material or information, by any means whatsoever.”

- “Exclusion – Access or Disclosure of Confidential or Personal Information and Data-Related Liability – with Limited Bodily Injury Exception.”
 - “arising out of any access to our disclosure of any person’s or organization’s confidential or personal information, including patents, trade secrets, processing methods, customer lists, financial information, credit card information, health information or any other type of nonpublic information.”
The exclusion then goes on to explain that it “applies even if damages are claimed for notification costs, of any person’s or organization’s confidential or personal information.

**Your D&O policy should not have a
cyber exclusion!!!**

Unauthorized Access

- *Universal American Corp. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 2015 WL 3885816 (N.Y. June 25, 2015)
- “fraudulent entry” into a computer system was limited to outside hackers, not fraudulent content submitted by authorized users.

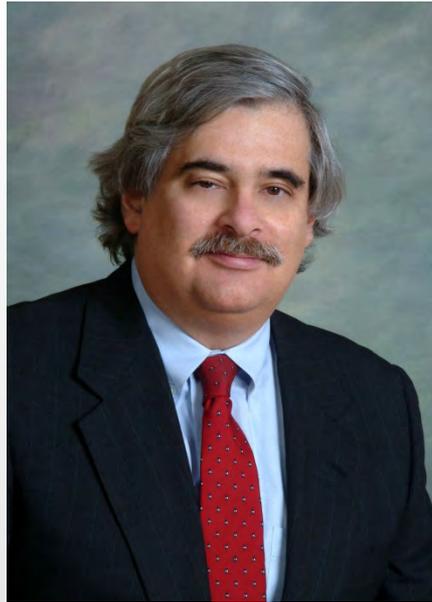
Columbia Casualty Company v. Cottage Health System., No. 15-3432 (C.D. Cal.).

- Insurer argued that insured failed to maintain adequate security in its network, including the failure to “continuously implement the procedures and risk controls identified in its application”; to “regularly check and maintain security patches on its systems”; and to “enhance risk controls.” (Complaint, ¶43.)
- Exclusion: “Any failure of an Insured to continuously implement the procedures and risk controls identified in the Insured’s application for this Insurance and all related information submitted to the Insurer in conjunction with such application whether orally or in writing[.]”
- Misrepresentation to underwriting

Medidata Solutions v. Federal Insurance Company

- Medidata was tricked into wiring \$4.8 million into an overseas account.
- Medidata had coverage as part of Federal Executive Protection Portfolio Policy - computer fraud, funds transfer fraud, forgery coverage
- Federal – “The policy provides coverage against involuntary transfers effected by hackers, forgers and imposters, not voluntary transfers effected by authorized signatories.”

Thank You



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Açaí

- The açaí palm is a species of palm tree in the genus Euterpe cultivated for its fruit and hearts of palm. Its name comes from the Brazilian Portuguese adaptation of the Tupian word iwaca'i, cries or expels water.





Key Cyber Coverage Cases: ACAI

- **Authorization**
- **Causation**
- **Act**
- **Injury**





Authorization

- **Authorization:** Courts have usually enforced restrictions and found for insurers.
 - Key Twist: Authorized persons acting fraudulently





Causation

- **Causation:**
 - What does “direct” mean?
 - Cases are split, with insurers enjoying an edge.
 - Impossible to reconcile causation cases.





Act

- **Act:**
 - Occurrence and Intent
 - Publishing
 - Hacking
 - Statutory Exclusion
 - Best Practices





Injury

- **Injury:** Even Split





THANK YOU

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10 Key Insurance Questions

1. Are key types of losses are covered (e.g., liability, property damage, computer damage, business interruption)?
2. What are the policy limits and sublimits for particular types of losses?



Aggregate Limits	Regulatory Claim	Crisis Management	Security Breach Remediation and Notification	Data Restoration	Business Interruption	Cyber Extortion
\$1,000,000	\$500,000	\$250,000	\$250,000	\$0	\$250,000	\$0
\$1,000,000	N/A	\$100,000	\$100,000	\$100,000	\$100,000	\$1,000,000
\$5,000,000	\$500,000	\$1,000,000			\$3,000,000	\$3,000,000
\$2,000,000	\$1,000,000	\$500,000	\$500,000	\$0	\$0	\$0

Note: Anecdotal – Small Sample Size

Source: 2014 Ponemon Study Data (P. 4-15)

10 Key Insurance Questions (continued)

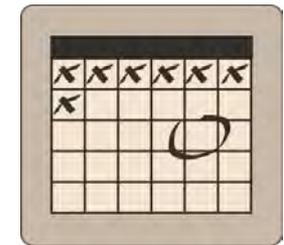
3. Does coverage extend to losses caused by the insured's third-party vendors?



4. Is there coverage for “fines” and “penalties”?



5. Is there a retroactive date?



10 Key Insurance Questions (continued)

6. Is there an “acts of foreign governments” exclusion?



7. Is there an exclusion covering programming/ processing errors, mechanical failures, and the like?



8. Is there an exclusion for “any loss caused by an employee”?



10 Key Insurance Questions (continued)

9. Is there an exclusion for an

D. The Columbia Policy Application

29. As part of the application submitted in connection with the Columbia Policy, Cottage completed and submitted a “Risk Control Self Assessment” in which it made the following relevant representations:

4. Do you check for security patches to your systems at least weekly and implement them within 30 days? • Yes
5. Do you replace factory default settings to ensure your information security systems are securely configured? • Yes
6. Do you re-assess your exposure to information security and privacy threats at least yearly, and enhance your risk controls in response to changes? • Yes

COLUMBIA CASUALTY COMPANY	Case No.: 2:15-cv-03432
Plaintiff.	COMPLAINT FOR DECLARATORY JUDGMENT AND REIMBURSEMENT OF DEFENSE AND SETTLEMENT PAYMENTS
v.	
COTTAGE HEALTH SYSTEM	
Defendant.	

- If so, the Columbia Policy contains an exclusion entitled “Failure to Follow Minimum Required Practices” that precludes coverage for any loss based upon, directly or indirectly arising out of, or in any way involving “[a]ny failure of an Insured to continuously implement the procedures and risk controls identified in the Insured’s application for this Insurance and all related information submitted to the Insurer in conjunction with such application whether orally or in writing.”

10 Key Insurance Questions (continued)

10. Are there any exclusions for claims alleging violations of consumer protection laws?

If so, does the policy at least provide defense cost coverage for these types of claims?

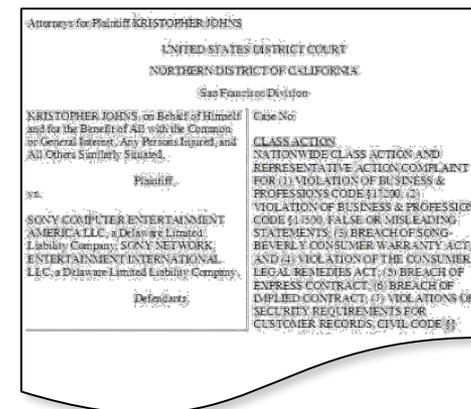


Image from "My Cousin Vinny" (20th Century Fox)

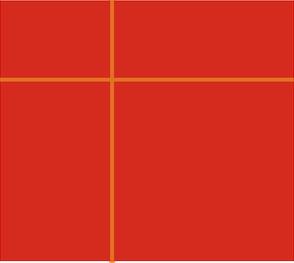
Thank You



Helen Michael

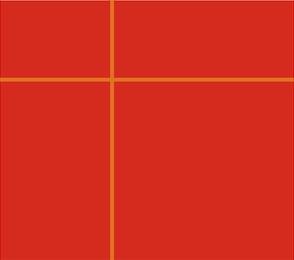
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LAW FIRM DATA BREACHES

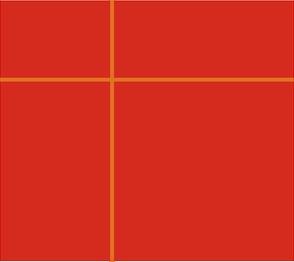
- Cravath Swaine & Moore LLP and Weil Gotshal & Manges LLP
- Law firms targeted by Russian hacker looking for M&A info
- Seven-figure sum paid for ransomware attack
- ABA Announcement re: Forwarding of FBI Cybersecurity Alerts



LAW FIRM DATA BREACHES

MOSSACK FONSECA (the “Panama Papers”)

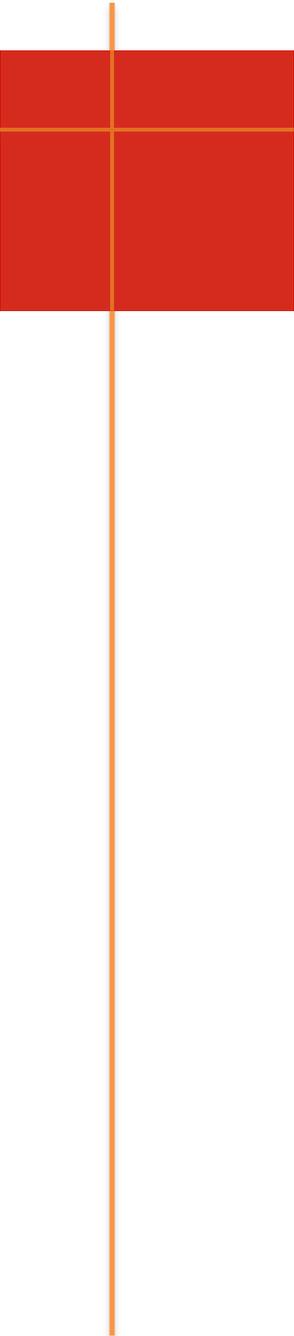
- Collection of 11.5 million files leaked to journalists
- Nearly every document from past 40 years
 - ❑ 2.6 terabytes
 - ❑ 4.8 million e-mails
 - ❑ 2.2 million PDFs
 - ❑ 320,000 text documents



LAW FIRM DATA BREACHES

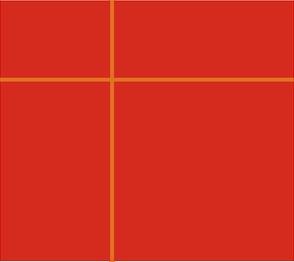
MOSSACK FONSECA (the “Panama Papers”)

- Resignation of Iceland’s Prime Minister
- British Prime Minister admits to profiting from offshore trust
- Criminal inquiry launched by U.S. Attorney in S.D.N.Y.



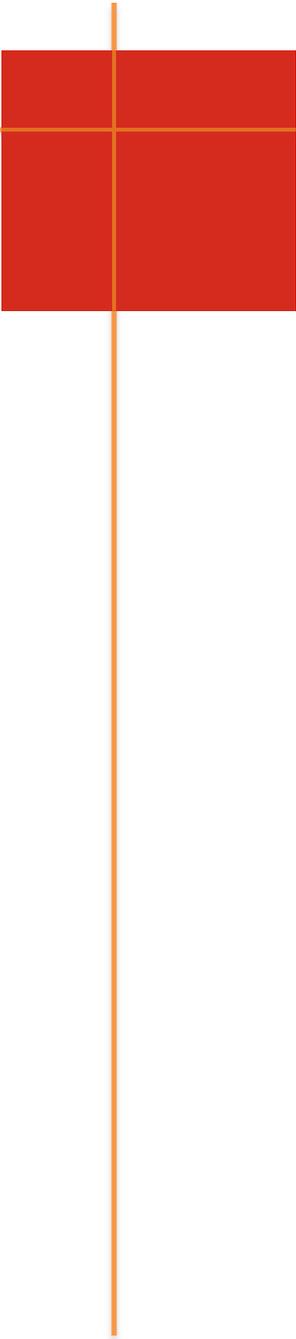
2015 ABA LEGAL TECHNOLOGY SURVEY REPORT

- 1 in 4 law firms with more than 100 attorneys have experienced a data breach
- Only 5% of firms that experienced breach notified clients
- 47% of respondents said firm had no response plan to address breach
- 58% said their firms did not have a dedicated staff member charged with data security
- 28% of firms with more than 100 attorneys had third-party conduct security assessment
- 48% of respondents did not know whether their firm had cyber liability insurance



RAMIFICATIONS

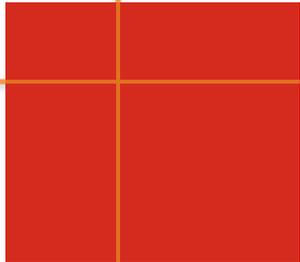
- Loss of Client Confidence
- Civil Liability
- Ethical Breaches
- Firm Survival



PROTECTION:

Top Ten Measures for Law Firms

1. Educate your personnel
2. Enforce a rigorous password protocol
3. Maintain a solid traffic management system
4. Control portable devices
5. Restrict remote and Wi-Fi access
6. Set a termination protocol
7. Audit for HIPAA compliance
8. Compartmentalize your system
9. Backup
10. Develop a breach plan now



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HOKE LLC
ATTORNEYS AT LAW

Energy Package Policies

2016 ACCEC Annual Meeting

May 4-6, 2016

Claude L. Stuart III

Shareholder

HALL MAINES LUGRIN, P.C.

Houston, Texas

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Myles A. Parker

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Jackson, Mississippi

Introduction

Myles and I will split the Energy Package Policy into:



Offshore



Onshore

Very Broad Topics



Quick Fly Over

The Offshore Energy Package Policy

The Central Role of the OEE/EED Policy Selected, Current Developments

Presented By:

Claude L. Stuart III

Shareholder

HALL MAINES LUGRIN, P.C.

Houston, Texas

London, England

5 May 2016

American College of Coverage and Extracontractual Counsel

First Half Goals Today

1. Set out broad overview of Offshore Energy Package Policy (OEPP)
2. Appreciate its central core is the OEE/EED Policy and clear up linguistic confusion re: COW
3. Trace the historical development of the OEE/EED Policy as a classic example of elegant underwriting
4. Explain the role of the newly promulgated COEE Policy
5. Highlight several recent, significant cases discussing OEPP



A Secret Revealed

- Both Myles and I have strong roots in Mississippi
- Our preparation exposed a long held, deeply shrouded **secret**
- About our fellow Mississippian
- We will share today what we learned from a very **secret** source:



Elvis and The President

The King's White House meeting is very well known



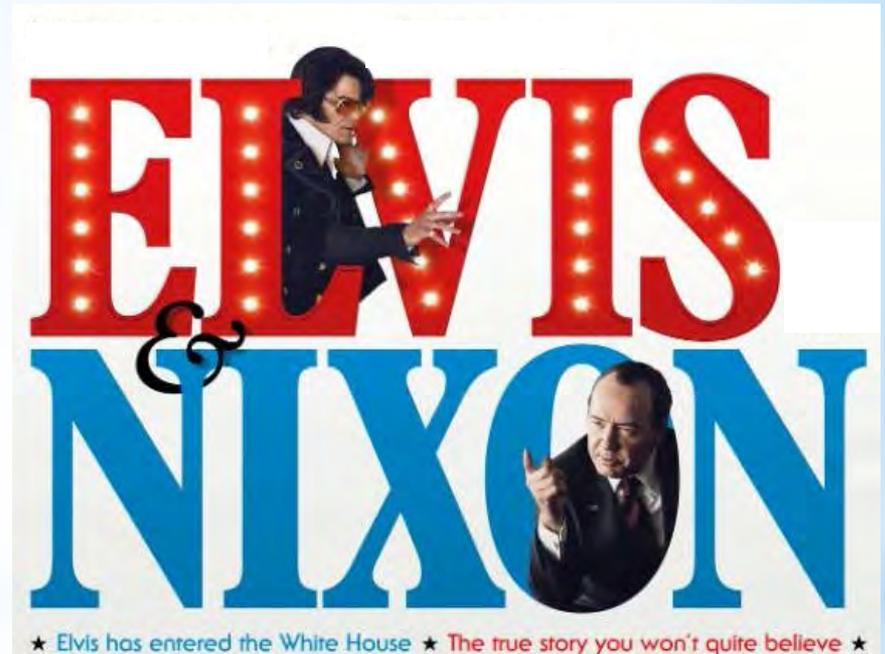
Conventional wisdom is Elvis wanted to carry a Treasury agent badge



But truth is indeed stranger than fiction or the movies.

Elvis and The President

President Nixon (a certified expert) was actually teaching Elvis how to make **secret tape** recordings.



Elvis and The President

Strengthening Elvis' **secret occupation** by recording the history and operation of the Energy Package Policy in real time.



Elvis and The President

Yes, Elvis led **two** lives:

1. Superstar Entertainer by night; and



Elvis and The President

Yes, Elvis led two lives:

2. Practicing, hands-on Offshore Energy Claims Adjuster by day



Commonality is Clear



Insurance (especially offshore risk)
is Legalized Gambling



Overview of Offshore Energy Package Policy



Tours by Elvis

Offshore Energy Package Policy

Operator's Extra Expense ("OEE") or Energy Exploration and Development ("EED") which themselves aggregate a number of related covers into a harmonious whole to aggregate the necessary **operational** and **property** covers:

1. Control of Well (COW) which itself includes:

- Section A: Control of Well
- Section B: Redrilling/Extra Expense
- Section C: Seepage and Pollution, Cleanup and Contamination
- Underground Control of Well
- Extended Redrill and Restoration
- Making Well Safe
- Care Custody and Control
- OPA Endorsement
- OPOL Endorsement
- Resultant Plugging and Abandonment Endorsement



Offshore Energy Package Policy

Operator's Extra Expense ("OEE") or Energy Exploration and Development ("EED") which themselves aggregate a number of related covers into a harmonious whole:

- Evacuation Expenses
- Deliberate Well Firing
- Contingent Joint Ventures
- Turnkey Wells Endorsement
- Farmout Wells Endorsement
- Developmental Drilling Wells Endorsement
- Wild Well Contractor Endorsement
- No Claims Return of Premium Endorsement
- Priority of Payments Endorsement
- Various Excess Cover Endorsements
- Windstorm Endorsement



Offshore Energy Package Policy

2. Physical Damage (“PD”)

- Physical Damage
- Removal of Debris (Removal of Wreck) (“ROD”, “ROW”)
- Sue and Labor
- Oil in Line
- Property in Transit
- Oil & Gas Well Drilling Tools Floater/All Risks

3. Pollution

4. Business Interruption (“BI”) including:

- Contingent Business Interruption (“CBI”)
- Loss of Production Income (“LOPI”)
- Contingent LOPI
- Loss of Hire
- Delay of Start Up

Offshore Energy Package Policy

5. Third Party Liability
6. Construction Risk
7. Charterer's Liability
8. Windstorm
9. Crude Oil Storage
10. Political Risk
11. War and Related Risks



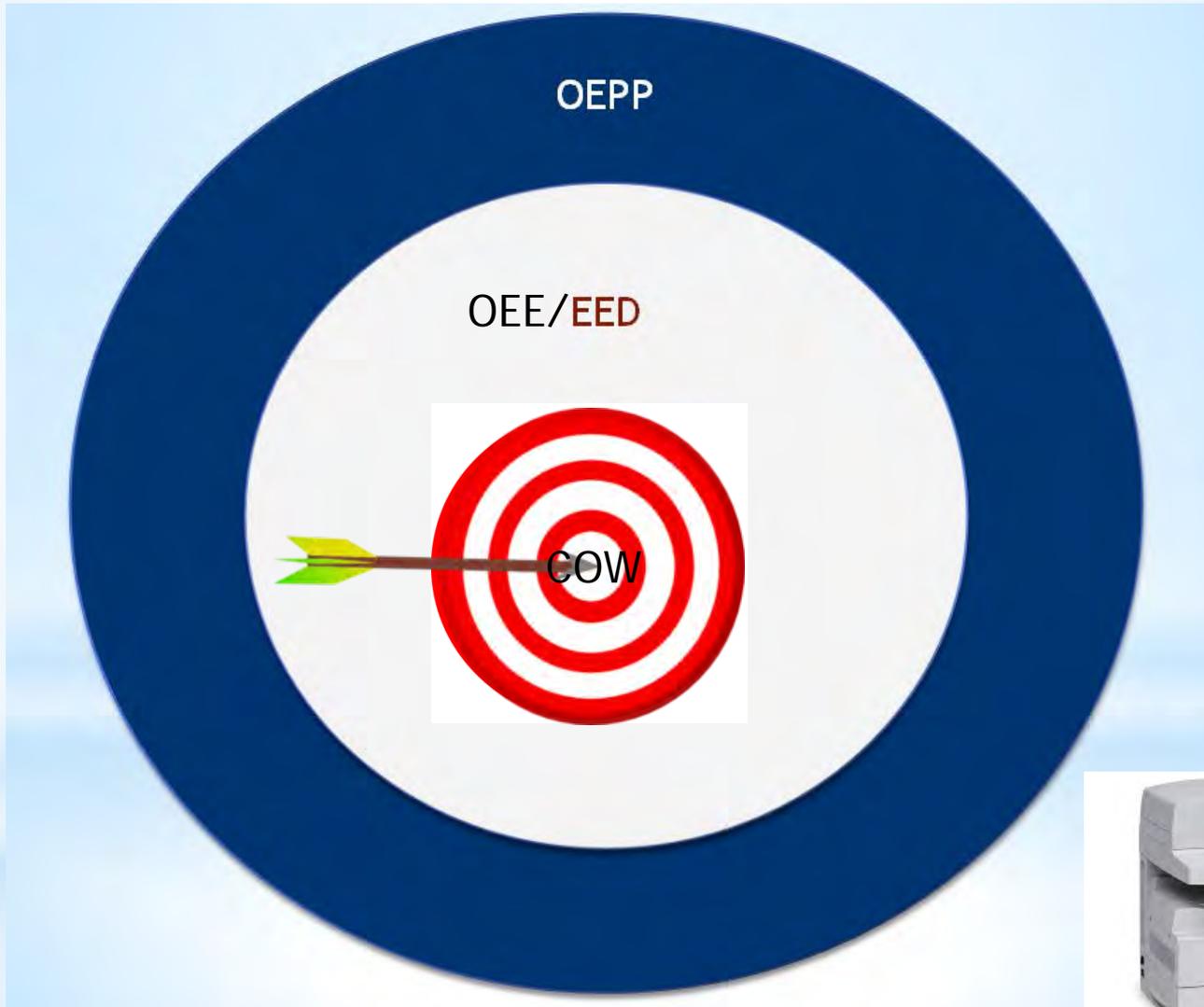
OVER 40 SEPARATE POLICIES

Control of Well





COW: Bull's-eye

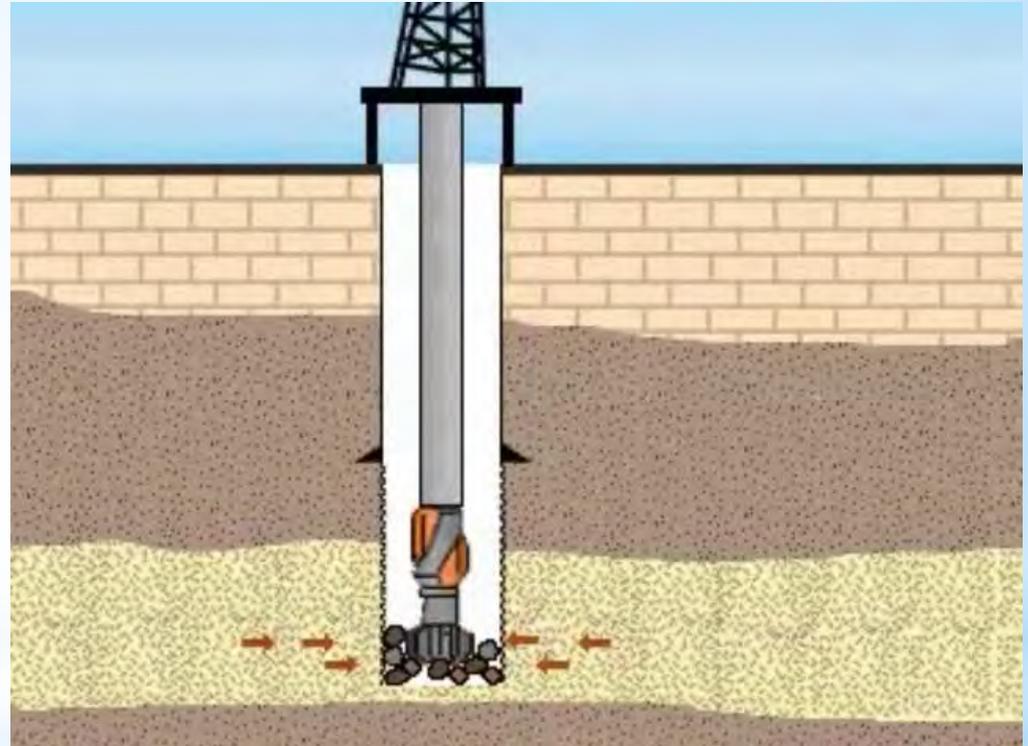


Classic Example of Elegant Underwriting



Classic Example of Elegant Underwriting History: Preface

- COW reimburses the insured for the often enormous costs incurred in controlling the well when it blows out
- COW must address the geoscience and inherent tension and continuation between “kicks” and “blowouts”



Classic Example of Elegant Underwriting History: Preface

- Underwriting COW coverage encounters two key problems:
 1. How to define “blowout” (and related expenses to control it)
 2. How to impose fairly operational and mechanical warranties on the insured, e.g., BOP
- Courts struck down repeated efforts as ambiguous
- Underwriters were paying for uncovered losses that imperiled the survival of the COW policy

Classic Example of Elegant Underwriting History: Preface

- COW bends policy language to fit court rulings on ambiguity
- Structures policy language to capture in “workable words” covered risks using a temporal concept
- Fairly imposes operational and mechanical warranties (e.g. BOP) and Due Diligence on the insured
- Clearly requires insured to make specific operational efforts before any liability on Underwriters is imposed
- Our review of history will explain how and why the present EED wording unfolded and works so well



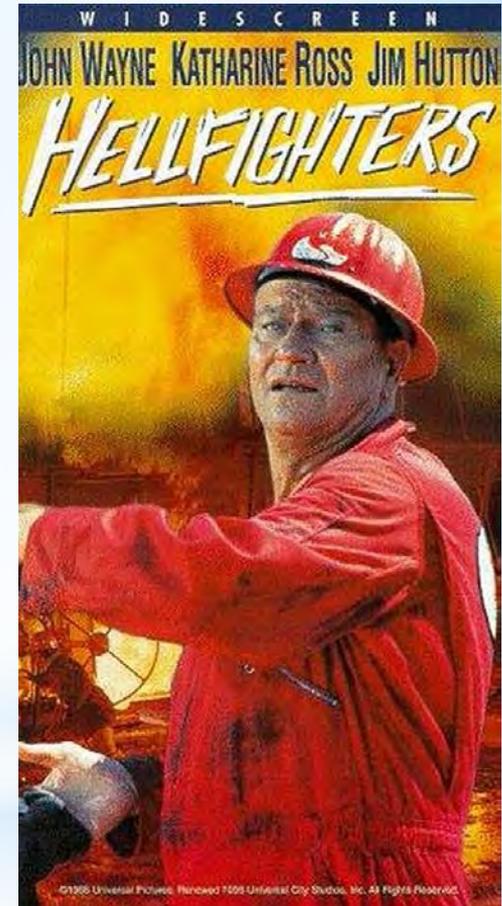
History: Up to the 1940s

- Blowouts of little consequence
- No significant offshore drilling
- Applicable PD policy limited to physical damage to land drilling rigs much like a contractor's heavy construction equipment
- Control of Well later included as an **add-on** to property policies
- Increasing capital flow after WWII into offshore drilling demanded insurance
- London Market rose to the challenge
 - Forms were very simple



History: Into the 1950s and 1960s

- Drilling began to move significantly offshore
- Realization that “blowouts” were a huge and growing expense to operators
- Early COW policies had either no or poor relevant definitions of “blowouts” or “kicks” - ambiguous



History: 1950s and 1960s continued

- Soon the expense of **redrilling** a blownout well and providing cover for **pollution** which accompanies a blowout became add-ons to the initial COW
- These three covers (COW, Redrill, Pollution) became collectively known as Operators Extra Expense (“OEE”)
- In the 1960s, London began to write offshore physical damage (“PD”)
- The Offshore Energy Package Policy was born



Review of Cases Driving EED Development

Georgia Home Ins. Co. v. Means, 186 F.2d 783 (5th Cir. 1951)

- “Blowout” defined as **uncontrolled flow** occurring when pressure entering the hole is greater than pressure exerted by drilling fluid column in the well
- Warranty of master gate drilling valve and Blowout Preventer (BOP): BOP not breached
- Insurer argued; therefore, no blowout or “wild well eruption”
- Court rejected as “premium on careless operation”
- Shows tension between BOP warranty and “blowout” definition
- Court pragmatically encourages use of safety devices which will not forfeit coverage



Review of Cases Driving EED Development

Fidelity-Phenix Fire Ins. Co. of N.Y. v. Dyer, 220 F.2d 697
(5th Cir. 1955)

- “Variations indicate an attempt ... to provide a more precise or limited definition of ‘blowout’ and to distinguish it from ‘kick’”
- Experts in drilling cannot give precise definition of these terms: a “**subtle**” problem
- Undaunted, insurers again argued no “complete lack of control of the drilling operation”, thus no coverage
- “Wild well” defense rejected by Court
- Insurers could have “**much more articulately**” defined the “required lack of control”
- A word to the wise: Why out of control and for how long?

Review of Cases Driving EED Development



Review of Cases Driving EED Development

Sutton Drilling Co. v. Universal Ins. Co., 335 F.2d 820 (5th Cir. 1964)

- Leading Fifth Circuit case by Chief Judge John R. Brown
- The question: “When is a blowout not a blowout?”
- “The heart of the whole controversy is the policy definition of blowout”
- Rejects Underwriters’ argument that proper working of BOP should render no coverage despite inability to use the well
- Such a view puts “whole emphasis on the mechanical result” of the BOP

Review of Cases Driving EED Development

Sutton Drilling Co. v. Universal Ins. Co., 335 F.2d 820 (5th Cir. 1964) (continued)

- “Those underwriting modern drilling risks surely do not seek irrelevant mechanical devices”
- “[A]lthough working perfectly, damage from otherwise uncontrollable pressures can in no way be prevented by the BOP, we think the insurer means to recognize that the BOP is ineffective”
- Courts continue to stress the “in control” and “out of control” notion with emphasis promoting use of safety devices: will be the keys to the EED

Review of Cases Driving EED Development



Review of Cases Driving EED Development

Atlantic Richfield Co. v. Underwriters at Lloyd's, London,
398 F. Supp. 708 (S.D. Tex. 1975) (Judge Carl Bue)

- Highly influential decision focusing on the key thrust of the earlier Fifth Circuit cases
- “In the insular world of oil and gas-drilling insurance, determining the breadth of, and liability for, insurance coverage begins with an **analysis of policy language**”



Review of Cases Driving EED Development

Atlantic Richfield Co. v. Underwriters at Lloyd's, London, 398 F. Supp. 708 (S.D. Tex. 1975) (Judge Carl Bue)(continued)

- Underwriters will reimburse the Assured for his expenses in the event of an oil or gas **well getting out** of control.
- Underwriters will pay necessary expenses to bring the **well under control**.
- A "**blowout**" occurs when pressure entering the well becomes greater than the pressure exerted by the drilling fluid before or after applying the BOPs, thus causing an expulsion of fluid preventing normal activities.

Review of Cases Driving EED Development

Atlantic Richfield Co. v. Underwriters at Lloyd's, London, 398 F. Supp. 708 (S.D. Tex. 1975) (Judge Carl Bue)(continued)

- Underwriters pushed restricted definition of the term “out of control”
- “Regaining control”, no compensation for combating the blowout preventing normal operations
- Insured successfully argued for all expenses incurred to return to normal activity, not when “blowout fires expire”
- Court noted “certain **general oil and gas well insurance principles** have evolved” per Chief Judge John R. Brown
- “That a blownout well is not blowing wild does not mean that the well is under control”
- **The task is clear**: While still wedded to trying to define “blowout” the Underwriters realized out of control and under control must be defined and comply with the principles laid out by the Fifth Circuit

Review of Cases Driving EED Development





History: 1970s

- Market dominant London OEE continues to encounter ambiguity rulings
- Policy was still covering more than was intended for premium paid
- Attritional losses become alarming to the Market
- Two big questions remain:
 1. How to define a covered “blowout”;
 2. And the exact role of operational/mechanical warranties imposed on the insured?

History: 1970s

- Tensions continue to persist between Underwriters' imposition of warranties and due diligence **versus** the Fifth Circuit's perception of what "should" be insured as a matter of public policy
- The **Joint Rig Committee (JRC)** thus drafted the **"1978 OEE Composite policy"**
- Still there were problems with ambiguity
- "Uncontrolled flow" assumed the question



History: 1980s

Control of Well

- JRC went back to work
 - Trying to match policy language to insurable risks
 - Complying with court objections on ambiguous terms and public policy issues
- It realized:
 - Either policy language had to be clarified or the COW policy was actuarially unsustainable and must leave the Market
 - Solution was to quit trying to define “blowout” but use a new linguistic structure balancing practical realities of drilling with risk that could be economically insured
 - Broad judicial hints from ambiguity findings and hard won experience of Underwriters from adverse case law led the JRC to craft the **Energy Exploration and Development policy (EED)** ; it would turn on a **temporal** notion

History: 1980s (Cont...)

Control of Well

- JRC finally realized asking the wrong question: impossible to answer what is a “blowout”
- **EED (8/86)** Emerged
- A “well out of control” was defined clearly
- A “well under control” was defined clearly
- The period of time between a “well out of control” and a “well under control” would form the basis of the expenses reimbursed to the insured



Well Out of Control —————> Well Under Control
Expenses

History: 1980s (Cont...)

Control of Well

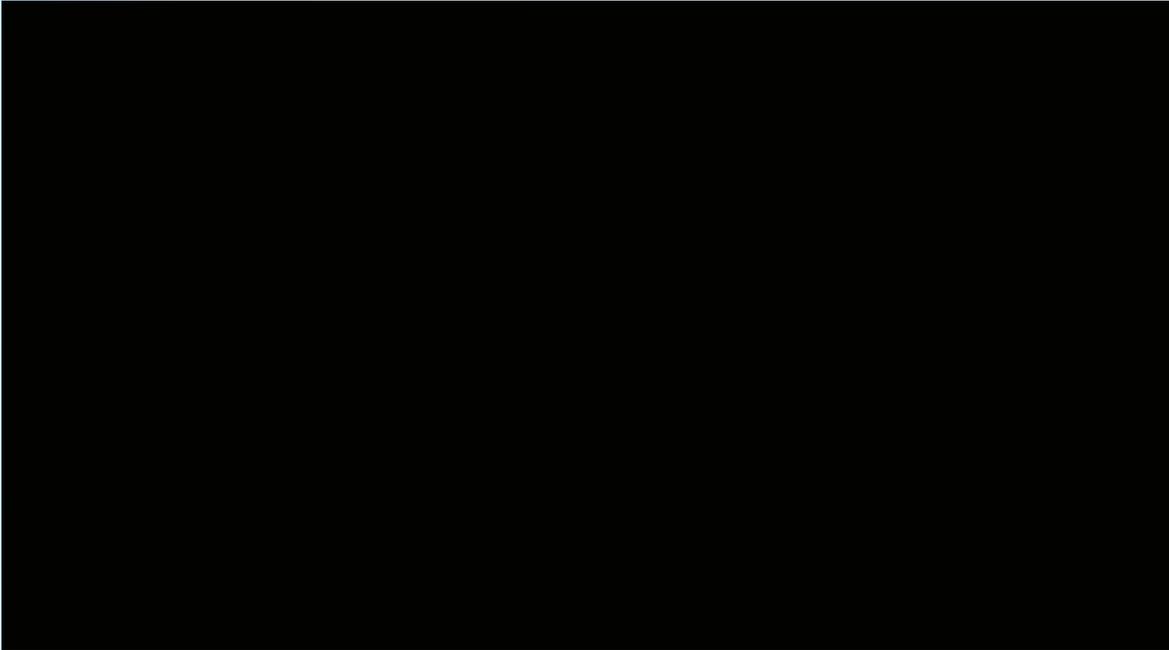
- The EED is an elegant solution standing the test of time
- EED wording **continues** to evolve to meet evolutionary changes in oil field technology and drilling environments

- Success at last



History: 1980s (Cont...)

Control of Well



Walk Through This World
With Me



EED More Closely Examined: The ABCs



EED More Closely Examined: The ABCs

Section



Control of Well

Section



Redrilling/Extra-expense

Section



Seepage and Pollution, Clean-up
and Contamination

EED More Closely Examined: The ABCs



Section A: Control of Well

Coverage

- Underwriters agree to reimburse the Assured for actual costs and/or expenses incurred by the Assured a) in regaining or attempting to regain control of any and all well(s) insured hereunder which get(s) out of control, but only such costs and/or expenses incurred until the well(s) is (are) brought under control as defined in Paragraph 2b of this Section A

Well Out of Control



For the purposes of this insurance, a well(s) shall be deemed to be out of control only when there is an **unintended flow** from the well(s) of drilling fluid, oil, gas or water **above the surface** of the ground or water bottom,

1. which flow **cannot** promptly be:
 - a. **stopped** by use of the equipment on site and/or the blowout preventer, storm chokes or other equipment required by the Due Diligence and Warranties clauses herein; **or**
 - b. **stopped** by increasing the weight by volume of drilling fluid or by the use of other conditioning materials in the well(s); **or**
 - c. **safely diverted** into production; **or**
2. which flow is **declared to be out of control** by the appropriate regulatory authority.

Nevertheless and for the purpose of this insurance, a well shall not be deemed out of control solely because of the existence or occurrence of a flow of oil, gas or water into the well bore which can, within a reasonable period of time, be **circulated** out or **bled off** through the surface controls. ("**Kick Exclusion**")

Well Brought Under Control

A well(s) deemed out of control is deemed to be brought **under control** at the time that:

1. the **flow** giving rise to a claim hereunder stops, is stopped or **can** be safely stopped; **or**
2. the drilling, deepening, servicing, working over, completing, reconditioning or other similar **operation(s)** taking place in the well(s) immediately prior to the occurrence giving rise to a claim hereunder is (are) **resumed** or **can** be resumed; **or**
3. the well(s) is (are) or **can** be returned to the **same** producing, shut-in or other **similar status** that existed immediately prior to the occurrence giving rise to a claim hereunder; **or**
4. the flow giving rise to a claim hereunder is or **can** be **safely diverted** into production;

whichever **shall first occur**, unless the well(s) continues at that time to be declared out of control by the appropriate regulatory authority, in which case, for the purpose of this insurance, the well(s) shall be deemed to be brought under control when such authority ceases to designate the well(s) as being out of control.



COW Recoverable Expenses



Expenses

Expenses recoverable hereunder shall include costs of materials and supplies required, the services of individuals or firms specialising in controlling wells, and directional drilling and similar operations necessary **to bring the well(s) under control**, including costs and expenses incurred at the direction of regulatory authorities to bring the well(s) under control, and other expenses included within Clause 1 of this Section A.

Termination of Expenses

In any circumstances and subject always to the Combined Single Limit of Liability of this policy, Underwriters' liability for costs and/or expenses incurred in regaining or attempting to regain control of a well(s) **shall cease when the well(s) is (are) brought under control** as defined in Paragraph 2b) of this Section A.

EED More Closely Examined: The ABCs

Section B: Redrilling/Extra-expense (continued)

- Must be section A event
- Most prudent and economical methods
- No coverage if flow can be diverted to production
- No coverage if can be completed through a relief well drilled for purpose of controlling the well
- Various percentage limitations on costs
- 540 day limit



EED More Closely Examined: The ABCs

Section C: Seepage and Pollution, Clean-up and Contamination

- Section A COW event
- Liable by law or lease
- Arising from wells (not platforms or other property)
- Can include defense costs
- Occurrence must be within the policy period
- Appropriate notice
- A Limited Cover



Combined Single Limit





The Evolution of the EED



PD Add-ons

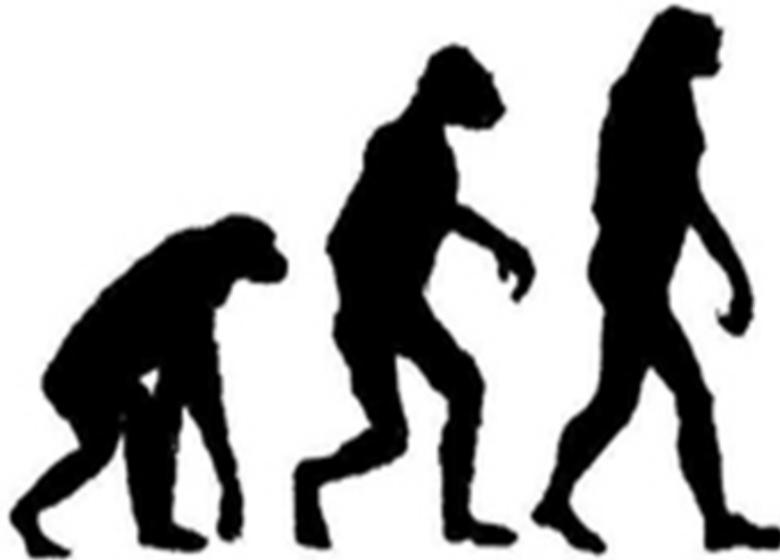
The Evolution of the EED



PD Add-ons

COW

The Evolution of the EED

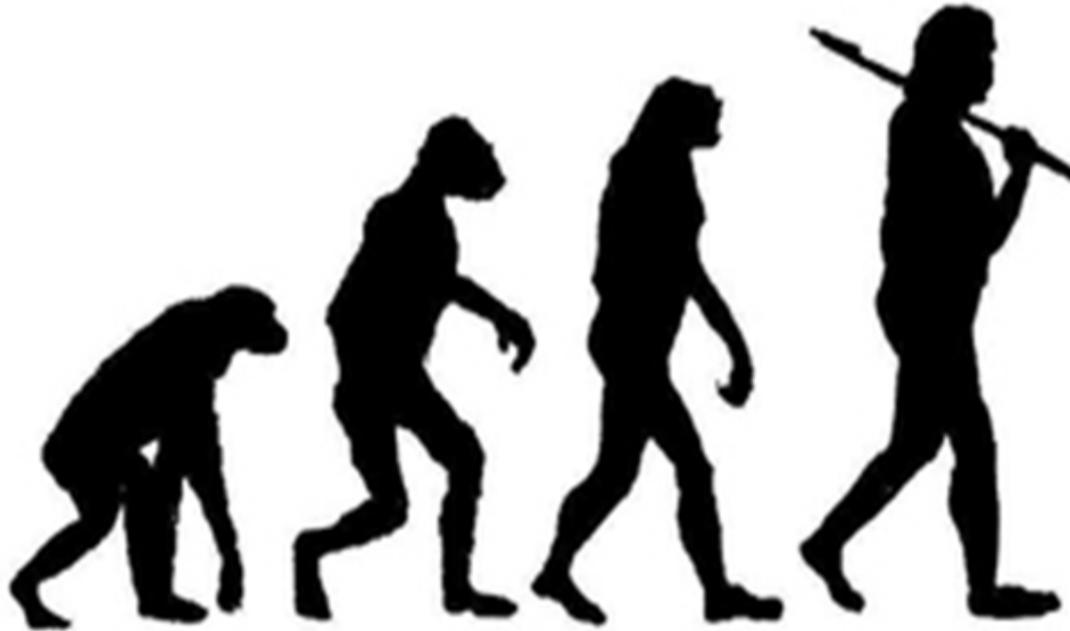


PD Add-ons

COW

OEE

The Evolution of the EED



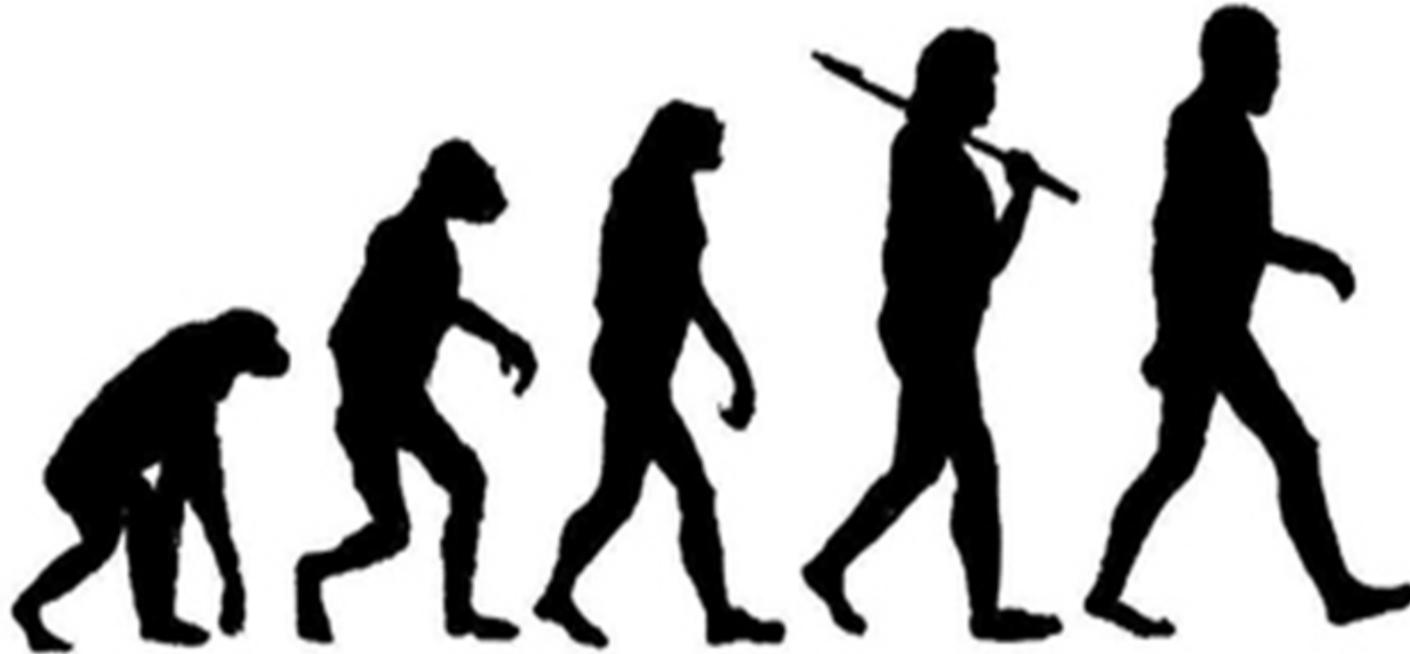
PD Add-ons

COW

OEE

EED

The Evolution of the EED



PD Add-ons

COW

OEE

EED

EED 2.0

Selective, Recent Significant Cases



*In Re: Deepwater Horizon ; No. 13-0670 ,In the
Supreme Court of Texas*

A Big Decision with Big Consequences Via a
Tortuous Route



Scope of Additional Assured Status

Crux of the case:

- Must you read the Transocean policy broadly naming BP as an Additional Assured for all purposes without limitation including subsea pollution, in a vacuum?

OR

- In tandem with the Drilling Contract/MSA, which limit's BP's coverage as an additional insured to only liabilities assumed by Transocean (only above surface), therefore no coverage?
- A \$750,000,000 question.

In Re Oil Spill By The Oil Rig “DeepWater Horizon” In The Gulf Of Mexico, On April 20, 2010, 2011 WL 5547259 (E.D. La. Nov. 15, 2011)

Judge Carl Barbier reasoned in denying BP cover:

1. “BP is an additional insured **only** for liabilities assumed by Transocean under the terms of the Drilling Contract. Thus, the Court must look to the terms of the Drilling Contract to determine the scope of coverage.”
2. “[I]t is **absurd** that (1) in the Drilling contract, BP would assume liability for subsurface oil releases; but then (2) in the same contract, oblige Transocean to name it as an additional insured providing coverage as to liability that BP assumed.”

Ranger Insurance, Limited

v.

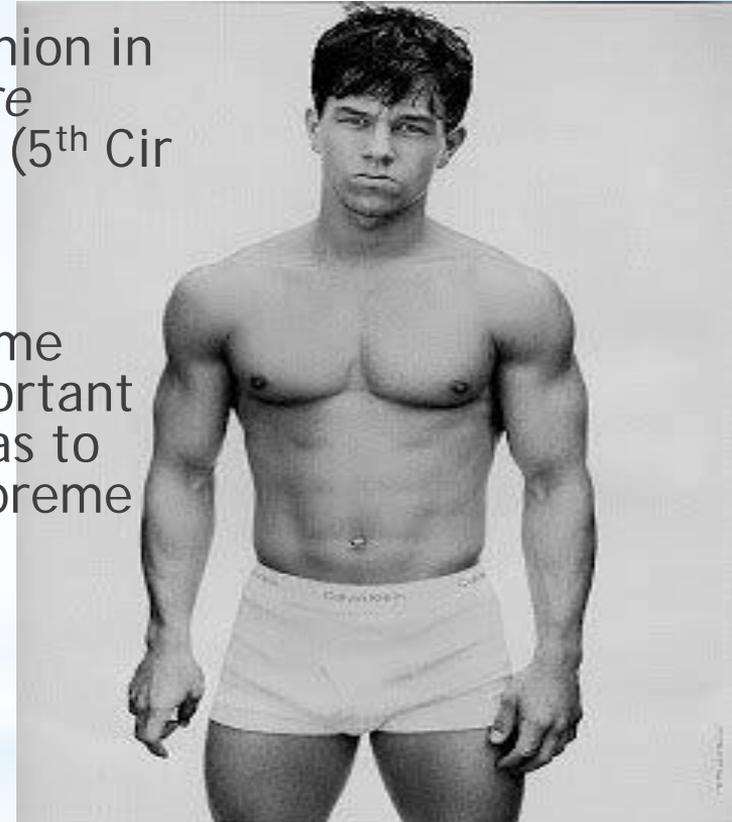
Transocean Offshore Deepwater Drilling et al, 710 F. 3d 338 (Fifth Cir. 2013)

Judge Grady Jolly reversed the trial court by reasoning:

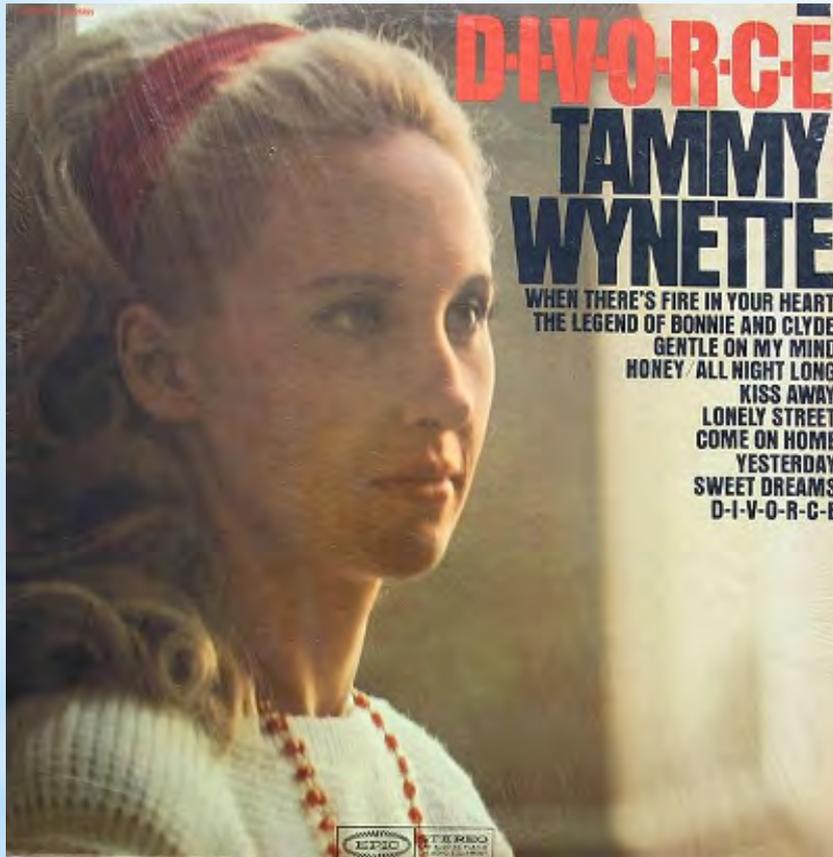
- “We find the umbrella policies ... do not impose any relevant limitation upon the extent to which BP is an additional insured”
- “The additional insured provision in the Drilling Contract is separate from an additional to the indemnity provision therein”
- “BP is entitled to coverage”

Ranger Ins., Ltd. V. Transocean Offshore Deepwater Drilling, Inc., 728 F.3d 491 (5th Cir. 2013)

- 5th Circuit **withdraws** Judge Jolly's opinion in *Ranger Ins. Ltd. V. Transocean Offshore Deepwater Drilling, Inc.*, 710 F.3d 338 (5th Cir 2013)
- Questions **certified** to the Texas Supreme Court because "this case involves important determinative questions of Texas law as to which there is no controlling Texas Supreme Court precedent"
- Garnered more **amicus briefs** than the Jockey Underwear Company



Scope of Additional Assured Status



To put it colloquially, are the two documents **married** together? Or are they subject to Tammy Wynette's soulful lament?



D-I-V-O-R-C-E

Scope of Additional Assured Status

The Texas Supreme Court holds:

1. Policy includes language that “**necessitates** consulting the drilling contract to determine BP’s status as an ‘additional insured’”
2. Under the drilling contract BP status is “**inextricably intertwined** with limitations on the extent of coverage to be afforded under the Transocean policies”
3. **Only reasonable** construction of BP status “as an additional insured is limited to the liabilities Transocean assumed in the drilling contract”
4. BP is **not entitled** to coverage for “damages arising from subsurface pollution because BP, not Transocean, assumed liability for such claims”



We're Together Again

*Eagle Oil & Gas Co. v. Travelers Property Cas. Co. of
Am., No. 7:12-cv-00133-O, 2014 WL 3406686
N.D. Tex. July 14, 2014)*



- Eagle Oil was attempting to open a stuck frac port sleeve by applying various levels of pressure.
 - A 7-inch piece of casing ruptured in the well.
 - The rupture caused the top casing joints to be ejected into the air.
-
- Allowed a flow of gas and fluid to the surface that could not be controlled.
 - Travelers urged **Due Diligence** violated by use of too much pressure causing casing to rupture



Figure 1. Fracture of the drill pipe

Due Diligence

5. EXCLUSIONS

There shall be **no indemnity** of liability under this Section I for:

* * *

c. for any claim arising out of any 'occurrence' caused in whole or in part, by any breach of any condition or warranty set forth in Paragraph 6. DUE DILIGENCE AND WARRANTIES below;

6. DUE DILIGENCE AND WARRANTIES

a. It is a **condition** that the Insured must exercise due care and diligence in the conduct of all operations with respect to any 'well insured', and by utilizing all safety practices and equipment generally considered prudent for such operations if any hazardous condition develops with respect to a 'well insured', the **Insured must at its sole expense** make all reasonable efforts to prevent loss, damage, cost or expense insured under this Policy.

Burden of Proof

Is it the Insured's covenant to exercise Due Diligence enforced by an **exclusion**, the breach of which Underwriters must prove?

OR

Is the exercise of Due Diligence a **condition precedent** to Underwriters' liability, which the Insured must prove?



Court's Logic

The Court noted, "In this case, both parties cannot **simultaneously** have the burden of proof on due care and diligence. To find otherwise would find a parallel-worded condition and exclusion to co-exist in an insurance policy allowing the policy to be susceptible to two reasonable interpretations regarding the applicable burden of proof. No rule of contract construction would support this outcome."

Lessons Learned



Courts must be careful not to read out of context with blinders on.

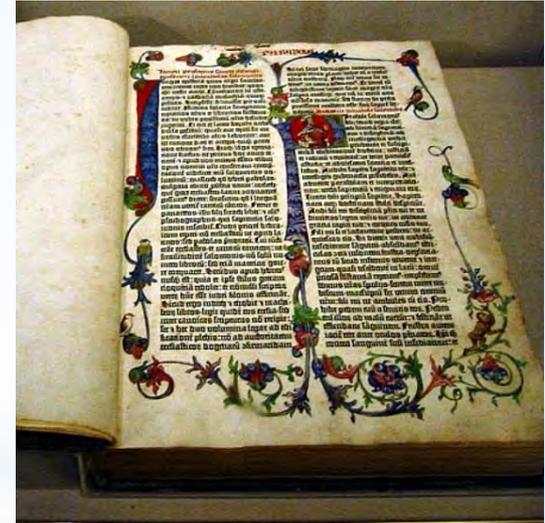
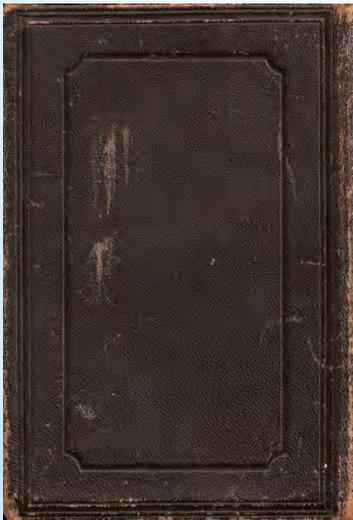
Ruling could shake a bedrock principle in COW policy.

Belt & Suspenders (Braces)



The Wisdom of Bo Diddley

Or as more eloquently and best put by Bo Diddley, courts should always remember...



YOU CAN'T JUDGE A BOOK BY LOOKING AT THE COVER

Contingent Operators Extra Expense (COEE)

- Promulgated by JRC as JR2016/004
- It notes: “This wording is purely illustrative and different policy conditions may be agreed.”
- Covers driller found to be grossly negligent
- So operator’s normal indemnity of driller is voided
- Continued Adaptability and Practicality of the London Market



A Primer on Property Insurance for Onshore Energy Risks

MYLES PARKER

STACEY STRACENER

CARROLL WARREN & PARKER PLLC

Onshore Energy Risks

Insurance for Construction of Onshore Energy Facilities

New facilities are continuously constructed in the energy sector, especially as many companies consider converting older coal-fired plants to more modern feedstock.

All or part of a current facility might be involved in construction, or the facility may be built from the ground up. **Property Insurance for Construction** includes:

- Builder's Risk (BR)
- Construction All Risk (CAR)
- Offshore equivalent is WELCAR
- Erection All Risk (EAR)



Onshore Energy Risks

Operational Property Insurance for Onshore Energy Facilities

- After Construction is Completed
- All “Hot Testing,” Performance Testing, and Commissioning Completed
- Often a condition precedent for **Operational Policy**



Onshore Energy Risks

Oops!

London Underwriter thought he insured this:



But he really insured this:



What happens?

Who pays for damage?

May not be covered by either Policy (CAR or Operational?).



Onshore Energy Risks

Lloyd's Wordings

Lloyd's Market Association (LMA) is "the representative body for underwriting businesses at Lloyd's." The LMA's mission is "to provide professional, technical support to the Lloyd's underwriting community. See LMA's Mon-Marine Committee Terms of Reference at § 2.1-2.2 (June 2013).

The various committees of the LMA draft "Wordings" for various types of risks, which **can** then be used by Underwriters and stored in the Lloyd's Wordings Repository.



Onshore Energy Risks

Testing & Commissioning Clause

Many London Onshore Energy policies contain a Testing & Commissioning Clause providing that the Operational policy does **not** cover the property until all testing and commissioning has been completed to design specification and has been maintained for a certain number of hours.

In January 2014, the LMA issued a new Wording for its Property & Plant Testing and Commissioning Clause LMA5197A and a questionnaire template for brokers and underwriters. The purpose of the **questionnaire** “is to facilitate the transfer of a newly constructed Onshore Oil, Gas & Petrochemical asset from a construction policy to an operational policy.” Very useful.

Onshore Energy Policy

Physical Damage

Construction Policies and Operational Policies both start with coverage for “direct **physical** loss” or “direct **physical** damage.”

What is Physical Damage?

- A tangible loss requiring physical repair or replacement of damaged covered property, such as pipelines, compressors, processing equipment, storage tanks and equipment, piping, boilers, gas or steam turbines, stock/inventory, and structures.
- Does **not** include coverage for “time related” **economic damages**

Onshore Energy Policy

Physical Damage

Wellington Underwriting Agencies Ltd. v. Houston Exploration Co., 267 S.W.3d 277 (Tex.App.-Houston [14th Dist.] 2008), aff'd, 352 S.W.3d 462 (Tex. 2011)

- Covered damage to platform under construction
- Tropical storms pass through, delaying repairs.
- Insured places repair vessels on “stand by” at significant daily cost until after storm
- Policy covered all risks of physical loss of or damage to property
- “Basis of recovery” was repair or replacement plus towage, installation and all other costs necessarily incurred and duly justified in repair or replacement
- Court: stand-by charges did not “naturally flow” from the damage to the platform jacket
- Stand-by charges **did not** constitute “physical loss or damage”; they were “caused only by a delay in the repairs.”



Onshore Energy Policy

Physical Damage

In the Construction context, Physical Damage **does not** include coverage for “time-related” economic expenses incurred when the PD causes the Project Schedule to be **delayed**.

This coverage must be added by endorsement or coverage extension to the typical CAR Policy. These coverages can include:

- Delay in Completion
- Delay in Start-Up (DSU)
- Advanced Loss of Profits (ALOP)
- Soft Costs
- Contractor’s Extra Expense

Onshore Energy Policy

Physical Damage

In the Operational context, Physical Damage **does not** include coverage for “time-related” economic loss incurred during the **time it takes to repair** the physical damage- the time the business can’t operate because of the PD.

This coverage **must be added** to the policy, and can include:

- Business Interruption (BI)
- Extra Expense (EE)
- Machinery Breakdown (Boiler & Machinery)
- Contingent Business Interruption (CBI)
- Extended Period of Indemnity (EPOI)

Onshore Energy Policy

The Package

More often than not, first-party insurance coverages (PD, BI, EE, CBI, EPOI, B&M) make up the Onshore Energy Package Policy. Occasionally, third-party liability insurance is included within the Package.

The LMA's Joint Power Generation Committee recently issued wording for Onshore Energy policies for Power and Utilities. See Power & Utilities Property Damage and Business Interruption Wording (USA), LMA3110.

Onshore Energy Policy

Property Commonly Excluded

Property Damage section typically **excludes** certain types of **property**, such as:

- Land or improvements to land
- Water (except that normally contained in a piping system, tank or processing equipment)
- Money, currency, notes, securities
- Mines or underground property
- Crops, timber
- Livestock
- Railroads, railroad rolling stock
- Offshore property except docks, wharves, piers or jetties extending from shore
- Electrical power distribution lines
- Motor vehicles, aircraft



Onshore Energy Policy Common Perils Excluded

Onshore Energy Policy typically **excludes** damage caused by **certain perils**. While policy language varies, these policies almost universally exclude perils, such as:

- Faulty Workmanship, Faulty Materials, Defective Design or Specifications
- Gradual deterioration, depletion, rust or corrosion, wear and tear, inherent vice or latent defect

Onshore Energy Policy

Faulty Work/Design Excluded

Ensuing Loss

Most Onshore Energy policies contain an exclusion for faulty workmanship or design, and most of these exclusions contain an exception for “ensuing loss.”

“**Ensuing loss**” clause “does not cover loss caused by the excluded peril; it covers loss caused to the property wholly separate from the defective property itself.” *RK Mech., Inc. v. Travelers Prop. Cas. Co. of Am.*, 944 F. Supp.2d 1013, 1016-17 (D. Co. 2011).

Ensuing Loss

944 F.Supp.2d 1013

- RK installed CPVC flanges, one cracked and caused water damage to the Project. RK replaced many other flanges.
- Process required certain building components. The cost to remodel and cover water damage was within ensuing loss.
- RK claimed the remaining flanges presented risk of direct physical loss, a **secondary loss** from excluded peril - faulty work or defective product not covered.
- Covers loss caused by water damage, not cracked flange

Onshore Energy Policy

Corrosion Excluded

Most energy-generating plants and oil refineries require large metal processing equipment which, when exposed to the elements, naturally deteriorates and corrodes over time. Thus, Onshore Energy policies typically include an **exclusion** for **gradual deterioration and corrosion**.



Onshore Energy Policy

Property Damage Extensions of Coverage

The Property Damage section of a typical onshore energy policy includes one or more of the following **extensions** of coverage:

- Debris Removal
- Demolition and Increased Costs of Construction
- Expediting Costs
- Professional Fees (Claims Preparation Costs)
- Service Interruption

These extensions broaden coverage to include certain costs in addition to repair or replacement of physical damage, usually subject to smaller **sublimits** of coverage.

Onshore Energy Policy Business Interruption

The Onshore Energy policy typically includes coverage for Business Interruption and Extra Expense. See Power & Utilities Property Damage and Business Interruption Wording (USA), LMA3110.

Business Interruption coverage developed as an outgrowth of, and **supplement** to, Property Damage coverage for the insured's own premises.

Business Interruption protects a company's lost **income stream** during repairs while the Property Damage coverage pays for repair of physical damage.

Onshore Energy Policy Business Interruption

The Business Interruption policy is not designed to cover all risk of loss of an insured's profits. Business Interruption coverage is tied to the requirement of **actual physical damage to covered property** by a peril not excluded in the Property Damage section of the policy.

Policy language of the BI section varies, but in order for the business loss to be covered, generally it must result directly from:

- (1) a covered peril that causes
- (2) physical loss or damage to
- (3) covered property, that causes
- (4) an interruption of business operations
- (5) during the period of restoration.



Onshore Energy Policy Physical Damage



**Elvis –The King of
Rock ‘n Roll—grew
up listening to the
Blues.**

**Without the Blues,
there would be no
Rock ‘n Roll. . .**



Onshore Energy Policy Physical Damage

*Without Physical Damage,
covered by the Policy. . .*

*No Time Element Coverage
for Business Interruption,
Extra Expense, Etc.*

“Let’s Get Physical” (Damage)



Onshore Energy Policy

Contingent Business Interruption

In developing the Contingent Business Interruption (CBI) policy, insurers **broadened** Business Interruption coverage to cover the insured's business interruption caused by **physical damage** to certain **third-party premises** upon which the insured's business was dependent.

“**Contingent**” is used in the sense that the insured's business is **dependent** upon others.

Contingent Business Interruption insurance also requires physical damage at the third-party premises due to the type of risk that would be covered under the insured's own Property Damage policy.

Offshore: LOPI and Contingent LOPI

Onshore Energy Policy Broker-Drafted Policy Language

Most Onshore Energy policies in the U.S. covering larger risks, such as power-generating plants and oil refineries, are “**quota-share subscription policies**” drafted by specialized insurance brokers.

These policies are typically issued by a combination of Lloyd’s Syndicates, domestic insurers, and foreign insurers based in Bermuda, Germany, and Switzerland, by subscribing to a certain percentage of the risk. Usually, the insurer with the highest percentage of risk is called the “**lead.**”

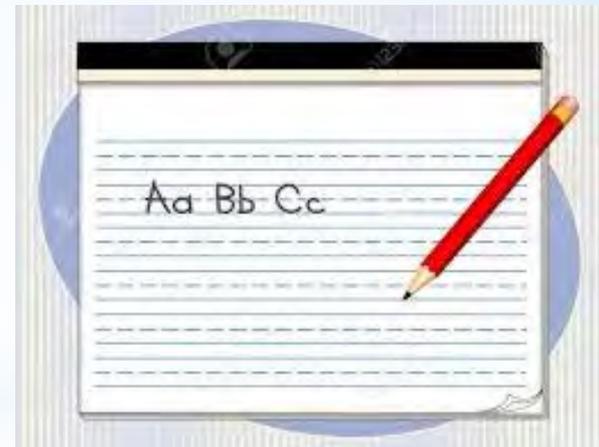
Onshore Energy Policy Broker-Drafted Policy Language

Although the Lloyd's Wordings Repository is filled with suggested policy language that has been vetted by experts in the particular sector of insurance coverage, the suggested Lloyd's Wordings are often **not** used.

In most subscription policies, the broker drafts the policy wording, which is called a "**manuscript policy.**"

It is not unusual for the language included in the manuscript policy wording to be unusual or inconsistent with underwriters' intent.

Query: the role of **contra proferentem**



Caveat

Always bear in mind this admonition from
The Essex when parsing policies.

Easier Said Than Done!



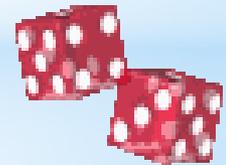
Conclusion

Secret source of Elvis' recordings was the third man in the Oval Office that day...



...Our own Ned Currie

Myles and I, like Elvis, would like to say to Ned for allowing us to use these recordings ...



Ned, thank you. Thank you very much. 101



REPRESENTATIONS & WARRANTIES INSURANCE

American College of Coverage and
Extracontractual Counsel

Annual Meeting
May 5, 2015

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REPRESENTATIONS & WARRANTIES INSURANCE

- What is RWI?
 - Insurance that guarantees the Seller's Reps & Warranties in an M&A-type transaction.
- RWI around since late 1990s.
- RWI now part of many of "Middle Market" deals (*i.e.*, deal values of \$25 million to \$2 billion)
- The existence of RWI was once viewed as a positive distinction, but now the absence is viewed as a detriment

REPRESENTATIONS & WARRANTIES INSURANCE

- Why is RWI popular now?
 - It took a while for deal players (execs, attorneys, advisors) to become comfortable with RWI on many fronts . . .
 - ◆ Evolution of RWI negotiation and placement process accommodating to deal timing
 - ◆ Standardization of concepts and terms
 - ◆ Familiarity with product, how it works, and that it works
 - ◆ Pricing at levels that make sense in the deal
 - Post-credit crisis increasing deal volume coincided with deal player comfort with RWI

EXAMPLES OF R&W SUBJECT MATTER

- Seller has power, authority and consents
- Deal will not violate articles, bylaws, contracts, court/regulatory orders, or law
- Accurate Financial Statements, Books & Records
- Adequate Internal Controls
- Solvency
- Assets are clear and in good condition
- Compliance with Labor & Employment/Employee Benefits Laws
- Contingent Liabilities including Litigation
- Taxes, Environmental and other exposures

WHAT HAPPENS IF R&W ARE FALSE?

- Buyer deprived of benefit of bargain
 - Buyer sues Seller
- Third Parties have rights against/sue Buyer
 - e.g., IRS, Regulators, Employees
 - e.g., Tax, Labor & Employment/Employee Benefits, Environmental

TRADITIONAL SOLUTIONS v. RWI

- Traditional Solutions: Risk allocated with sales proceeds
 - Buyer pays discounted purchase price
 - Buyer holds back portion of purchase price
 - Parties escrow portion of purchase price
- RWI: Insurer assumes risk in exchange for premium
 - Need for Traditional Solutions mitigated or eliminated

WHY USE RWI INSTEAD OF TRADITIONAL SOLUTIONS?

- Seller
 - More cash out of deal and quicker
 - Mitigate need for post-closing involvement
 - Relationship issues
 - ◆ e.g., Seller's ownership/management may continue as Buyer's management – awkward for Buyer to sue Seller
- Buyer
 - Wants more security than Seller is willing to give
 - Concerns about validity of reps & warranties
 - Concerns about Seller's ability to pay damages resulting from a breach
 - Concerns about costs of pursuing Seller for breach
 - Concerns about logistics pursuing Seller (e.g., cross border transactions)

ALTERNATE FORMS OF RWI: “SELL-SIDE” RWI

- “Sell-Side” RWI
 - Seller is insured
 - Sell-Side RWI provides Liability coverage
 - Liability coverage
 - Applies in the event of a claim or suit against the Seller based on an alleged breach of R&W
 - Reimburses Seller for Defense Costs
 - Reimburses Seller for Settlements/Judgments

ALTERNATE FORMS OF RWI:

“BUY-SIDE” RWI

- “Buy-Side” RWI
 - Buyer is insured
- “Buy-Side” RWI provides First Party and Liability coverage
 - First Party Coverage
 - ◆ Insurer reimburses Buyer for losses associated with Seller’s breach of R&W
 - Liability coverage
 - ◆ Applies in the event of a claim or suit against the Buyer related to Seller’s breach of R&W
 - ◆ Reimburses Buyer for Defense Costs
 - ◆ Reimburses Buyer for Settlements/Judgments

BUY-SIDE RWI v. SELL-SIDE RWI

- Buy-Side RWI used substantially more frequently than Sell-Side RWI
 - Seemingly easier way to shift exposure to insurer
 - ◆ If there's a breach that results in a loss to the Buyer, the Insurer pays
 - ◆ Eliminates need for Buyer to sue Seller to trigger Sell-Side coverage
 - ◆ Eliminates prospect of litigation against Seller -- Insurer's subrogation rights are usually limited to cases of fraud or other dishonest conduct

BUY-SIDE RWI v. SELL-SIDE RWI

- Sell-Side RWI Disadvantages
 - Merely indirect, if any, benefit to Buyer; Traditional Solutions (e.g., discount, escrow, holdback) still required
 - Riskier to underwrite Sell-Side Policy--RW validity/breach is within Insured's control
 - ◆ Placement period is likely extended
 - ◆ Markets do not have access to buyer's due diligence
 - Exclusions and other limitations are stricter
 - Likely no price break over Buy-Side Policy

RWI and DEAL STRUCTURE

- RWI is most often used in “Middle Market Deals” -- \$25 million to \$2 billion
 - Middle Market deal size is sufficient to bear RWI costs
 - Insurer capacity and appetite diminishes with substantially larger deals
 - Insurers reluctant to do smaller deals because margin is thin based on transaction costs
 - Check the market because insurers are adapting and some may be willing to underwrite smaller deals

RWI and DEAL STRUCTURE

- RWI is subject to a retention – i.e., the insurance proceeds are only available in excess of specified losses
- Buyer and Seller structure deal agreement in collaboration with Insurer
 - Buyer and Seller may agree that Seller is responsible for first \$X,000,000 of losses
 - Insurer would set retention at \$X,000,000
 - Buyer and Seller consult with Insurer in structuring agreement to ensure that Insurer will provide coverage subject to retention of \$X,000,000 (Insurer typically agrees to 1-2% of deal value)

RWI and DEAL STRUCTURE

- RWI is subject to a limit – i.e., the insurer will only provide \$XX,000,000 in coverage for the deal.
- Buyer and Seller structure deal working with Insurer
 - Buyer and Seller may agree to limit damages to the limit of the RWI insurance.
 - ◆ Insurer would set limit at \$XX,000,000
 - ◆ Buyer and Seller consult with Insurer in structuring agreement to ensure that damages are limited to the amount of the coverage limit, which is \$XX,000,000.
 - Buyer and Seller may agree not to limit damages to limit of the RWI insurance.

RWI POLICY LIMITS and PRICING

- Pricing and availability of limits varies based on market conditions, but . . .
 - Many insurers offer \$10MM as a minimum limit
 - Fewer insurers offer \$5MM-\$100MM
 - Handful may offer \$2.5MM-\$5MM
- Pricing is in the range of . . .
 - ~4.5-5.5% for limit of \$2.5MM-\$5MM
 - ~3.0-4.5% for limit of \$5MM-\$10MM
 - ~3.0- ~4.0% for limit >\$10MM

LIMITATIONS/EXCLUSIONS

- Coverage is provided during the pertinent Policy Period.
 - Policy may have multiple Policy Periods corresponding to particular Reps & Warranties
 - Policy Periods typically multiple years in duration
- Coverage is provided net of other recoveries to insured

LIMITATIONS/EXCLUSIONS

- Exclusions
 - Matters identified in underwriting and described in schedule to policy
 - Matters of which members of “Deal Team” had knowledge
 - Matters disclosed in the deal documents
 - Fraud by the insured or a member of the Deal Team
 - Specific indemnity obligations
 - Employee benefit liability or withdrawal liability
 - Claims based on forward looking statements

RWI PLACEMENT PROCESS--PLAN AHEAD

- Process takes time (usually at least two weeks)
- Broker is key facilitator of placement process
- Engagement of broker should occur in advance
- Experienced brokers and insurers are accustomed to lawyers and deadlines
- Placement process involves many steps

STEPS IN RWI PLACEMENT PROCESS

- Execute Non-Disclosure Agreements with prospective insurers
- Provide deal documents, financials and related information to prospective insurers for purpose of getting indication of pricing and other terms for RWI
- Insurers provide indications of pricing and other terms to broker at (no cost)
- Broker works with Buyer (Seller) and lawyers to evaluate insurer indications and compatible integration with deal
- Buyer (Seller) selects insurer and pays non-refundable due diligence fee (\$15-30,000) which primarily goes to law firm hired by insurer
- Insurer (Insurer's counsel) is given access to relevant due diligence information, which provides basis for insurer quote
- Buyer (Seller), Broker and Counsel consult, negotiate and finalize details of coverage with insurer
- Coverage is finalized and bound at closing, when premium is paid

COMMENTARY

- It is vital to work with a Broker that has RWI and M&A expertise, as well as current knowledge of market players and conditions, which are fluid
- Insurers seem to be more flexible and nimble/responsive in placing this coverage than other types of coverage
- Insurers are willing to tailor policy terms and ability to recognize/implement reasonable and mutually beneficial terms and changes in language
- Favorable conditions are probably attributable to relative immaturity of RWI product, and new insurer entrants to the market
- Unlikely that the favorable conditions will be permanent – stay tuned

THANK YOU FOR COMING

QUESTIONS?

GLOBAL COVERAGE IMPLICATIONS FROM
CLIMATE CHANGE
ACCEC 2016 ANNUAL MEETING
MAY 4-6, 2016 Chicago, Illinois

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What Is Climate Change?

- Climate change is a change in the usual weather found in a place
 - How much rain a place usually gets in a year
 - Change in temperature for a month or season
- Climate change is a change in the usual weather found in a place
- Consensus in the scientific community that the climate is changing with risk to the global economy and ecology.

- **Examples:**
 - Flooding
 - Windstorms
 - Wildfires
 - Earth Movement
 - Subsidence & Sinkholes
 - Mold and Moisture Damage
 - Disease



Effects Of Warming Can Be Seen In The Recession Of Glaciers

Sperry Glacier
Glacier National Park, MT



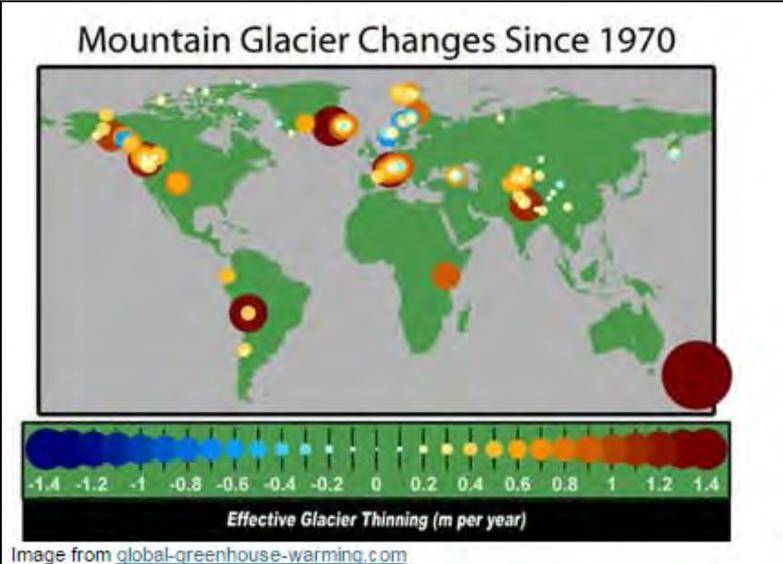
Chaney Glacier
Glacier National Park, MT



Grinnell Glacier
Glacier National Park, MT

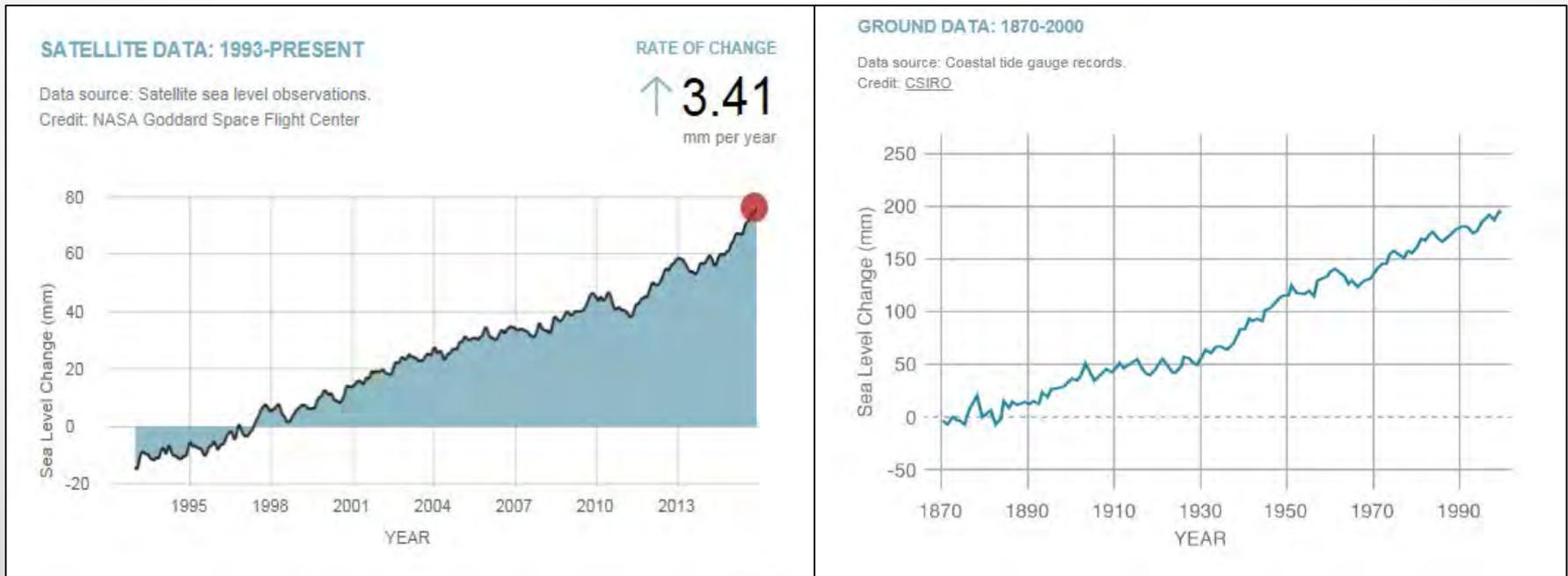


1938 T. J. Hileman photo Courtesy of GNP Archives
1981 Carl Key photo USGS
1998 D. Fagre photo USGS
2006 Karen Holzer photo USGS



Effects of Rise In Carbon Dioxide Levels

- Rising Sea Levels
 - Melting of masses of ice/ice sheets around the world
 - Most of the world's mountain glaciers and ice sheets have lost mass over the last century
 - Sea level has been rising since the mid-19th century primarily as a result of human-induced climate change
 - Expansion of Sea Water as it Warms



Rising Sea Levels:

- Caused by thermal expansion, melting of glaciers and ice caps and loss of ice from Greenland and West Antarctic ice sheets
- Sea levels rising dramatically along the eastern seaboard and Gulf of Mexico
- Relative sea level change is most dramatic in most vulnerable areas
- Over 600 million people live in coastal areas that are less than 10 meters above sea level, and two-thirds of the world's cities that have populations over five million are located in these at-risk areas
- Environmental Protection Agency estimates that 26,000 square kilometers of land would be lost should sea level rise by 0.66 meters

Trend of Sea Level Change (1993-2008)

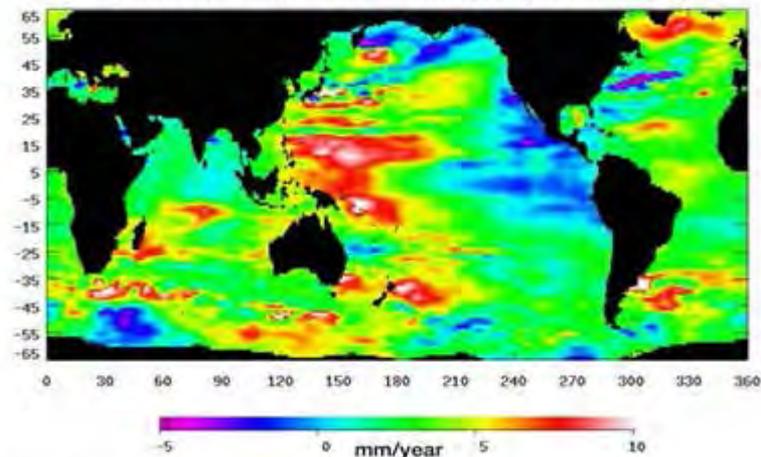


Image from [NASA](#)

Relative Sea Level Change Along U.S. Coasts, 1960-2014



Relative sea level change (inches):



Data source: NOAA (National Oceanic and Atmospheric Administration). 2015 update to data originally published in: NOAA. 2009. Sea level variations of the United States 1854-2006. NOAA Technical Report NOS CO-OPS 053. www.tidesandcurrents.noaa.gov/publications/Tech_rpt_53.pdf.

For more information, visit U.S. EPA's "Climate Change Indicators in the United States" at www.epa.gov/climatechange/indicators.

Miami is particularly vulnerable to coastal flooding:

- Already South Florida faces annual \$672M losses from flooding
- Florida has had an unusually long 10 year no-hurricane streak
- Appx. \$366B worth of real estate would be exposed in a worst case scenario 100-yr flood [NY - \$237B; NOLA - \$144B]
- Expected 6-10 inches of sea level rise by 2030; storm surge of 5 feet



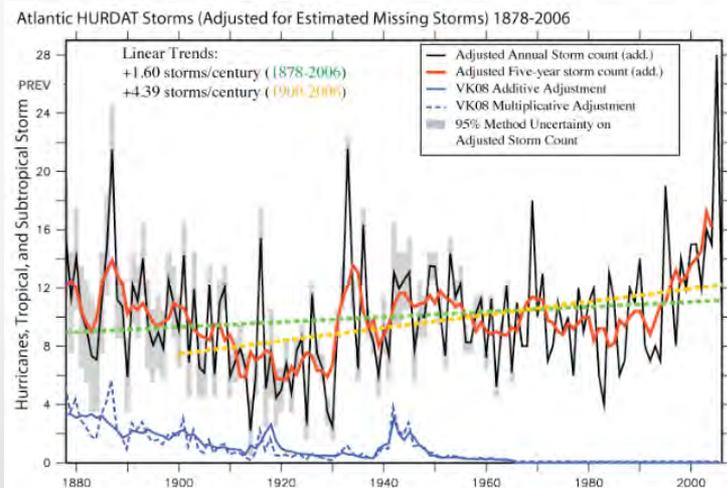
Regional Impact of Climate Change

- Northeast:** Heat waves, heavy downpours and sea level rise pose growing challenges to many aspects of life in the Northeast. Infrastructure, agriculture, fisheries and ecosystems will be increasingly compromised. Many states and cities are beginning to incorporate climate change into their planning.
- Northwest:** Changes in the timing of streamflow reduce water supplies for competing demands. Sea level rise, erosion, inundation, risks to infrastructure and increasing ocean acidity pose major threats. Increasing wildfire, insect outbreaks and tree diseases are causing widespread tree die-off.
- Southeast:** Sea level rise poses widespread and continuing threats to the region's economy and environment. Extreme heat will affect health, energy, agriculture and more. Decreased water availability will have economic and environmental impacts.
- Midwest:** Extreme heat, heavy downpours and flooding will affect infrastructure, health, agriculture, forestry, transportation, air and water quality, and more. Climate change will also exacerbate a range of risks to the Great Lakes.
- Southwest:** Increased heat, drought and insect outbreaks, all linked to climate change, have increased wildfires. Declining water supplies, reduced agricultural yields, health impacts in cities due to heat, and flooding and erosion in coastal areas are additional concerns.

Change in Hurricane Models

- There is some evidence that climate change increases the intensity of hurricanes.
- Theories and computer models predict a 5% increase in wind speeds for every 1°C increase in tropical ocean temperature.*
- Debate continues over whether climate change increases frequency of hurricanes.

*Emanuel, 326 Nature No. 6112, pp. 483-85, *The dependence of hurricane intensity on climate* (1987); Knutson and Tuleya, 17 J. Climate No. 18, pp. 3477-95, *Impact of CO₂-induced warming on simulated hurricane intensity and precipitation: Sensitivity to the choice of climate model and convective parameterization* (2004)



Coastal storm surge threat from a Category 4 hurricane



“Global warming could lead to a 2 to 5 percent increase in hurricane peak wind speeds over the next 20 years, which in turn could result in a **30 to 40 percent increase** in property insurance losses.”

– Insurance Information Institute, *Climate Change: Insurance Issues*; <http://www.iii.org/issue-update/climate-change-insurance-issues>.

Continental United States Hurricane Strikes 1950-2007



Hurricane Katrina

- 1,833 estimated deaths; over 1M displaced
- \$152.5 billion in damage; Private insurance estimated losses were between \$40 and \$60 billion; Total losses estimated at \$200 billion with the government contributing \$100 billion
- Katrina's storm surge led to 53 levee breaches in New Orleans
- Katrina damaged or destroyed 30 oil platforms and caused the closure of nine refineries in the Gulf of Mexico
- According to the U.S. Dept. of Housing and Urban Development:
 - 81% of housing units in St. Bernard Parish were damaged
 - 70% of housing units in St. Tammany Parish were damaged
 - 80% of housing units in Plaquemines Parish were damaged



Superstorm Sandy

- \$67.6B in damage (adjusted)
- NYSE was closed on Oct. 29-30 due to power outages and flooding caused by Hurricane Sandy (first time since 1888)
- 2.6M customers in NJ were without power at the peak of the storm; outages continued through Nov. 10-11
- Fire in Breezy Point, Queens burned more than 80 homes
- The MTA said that the destruction was the worst disaster in the 108-year history of the New York City subway system
- Named storm deductibles



Industries Affected By Climate Change

- Industries with a global supply chain
- Real Estate and Construction
- International Shipping
- Livestock / Farming / Fishing

Decline in bumblebees populations suggest an elevated susceptibility to rapid climate change.

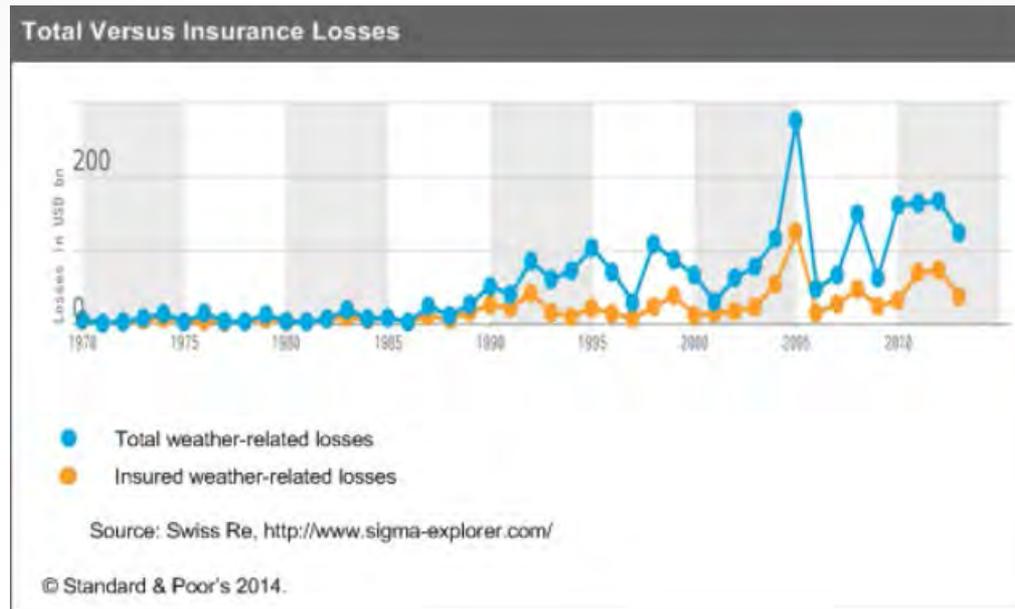
See, e.g., Kerr, et al., 349 Science 6244, pp. 177-180,

Climate change impacts on bumblebees converge across continents (2015)



- January 2016 winter weather alone caused \$4B loss to the global economy (\$2B in US, \$1.6B in China)
- By 2030 the cost of climate change and air pollution combined will rise to 3.2% of global GDP, with the least developed nations to suffer losses of up to 11% of the GDP
- Energy
 - Increases in temperature will likely change how much energy we consume, as well as our ability to produce electricity and deliver it reliably.
 - Water Use
- Transportation
- Tourism

Impact on the Insurance Marketplace



- S&P reported that insurers' capital positions could be affected by lower investment income, higher capital requirements and an increase in weather related claims – current projections are a reduction of capital adequacy, resulting in lower dividends
- Scope is unpredictable because extent of change unknown
- “The question is no longer whether global warming is happening, but how it will affect our business, as well as our personal lives.” – Swiss Re CEO, John Coomber
- 2008 survey by Ernst and Young of top insurance industry analysts from around the world disclosed that climate change was deemed to be the number one risk facing the industry.

Coverage Issues Raised After A Natural Disaster

- “All risks” policies: all causes of loss not expressly excluded
- Property damage, wind and flood coverage
- Business interruption coverage
- Contingent business interruption & extra expense coverage
- Debris removal
- Code upgrade coverage
- Sue and labor coverage (Expenses to prevent loss)
- Interdependency coverage
- Mold
- Civil authority coverage
- Exclusions: Flood; Wind-driven rain; storm surge; looting

Other Climate Change Related Claims and Coverage

Potential Long Tail Nature of Climate Change Claims:

- **Native Village of Kivalina v. ExxonMobil Corp. et al.** (N.D. Cal.) (appealed)
(Filed Feb. 26, 2008; MTD Granted Sept. 30, 2009)
 - Inupiat Eskimo Fishing Village in Alaska sued 24 energy companies for the costs of relocating village required as a result of environmental damage from climate change
 - “Defendants contribute to global warming through their emissions of large quantities of greenhouse gases...All Defendants directly emit large quantities of greenhouse gases and have done so for many years. Defendants are responsible for a substantial portion of the greenhouse gasses in the atmosphere that have caused global warming and Kivalina’s special injuries.” (Complaint ¶ 3.)

- **People of State of California v. General Motors Corp. et al.** (N.D. Cal.)
(Filed Sept. 20, 2006; MTD Granted Sept. 17, 2007) (appealed)
 - CA AG sued automobile manufacturers for costs incurred by state from climate change based upon emissions of their products
 - “Defendants contribute to carbon dioxide and other greenhouse gas emissions on a very large scale, and thereby cause and contribute to global warming. Defendants’ carbon dioxide and other greenhouse gas emissions have caused and are causing significant damage to the State of California, both to natural resources of the State and to the State fisc.” (Complaint ¶¶ 20-21.)

- Plaintiff alleges that continuous release of gasses build up in atmosphere and cause injury in aggregate over time:
 - Continuous Trigger: each gaseous release causes additional damage resulting in ultimate injury?
 - Exposure Trigger: what is the date of “exposure” to climate change?
 - Manifestation Trigger: coverage turns on date of damages claimed; when does erosion/sea rise occur?
 - Injury-in-fact: what is the specific injury alleged? Costs of repair,

Other Climate Change Related Claims and Coverage

Any Coverage Under a CGL Policy?

- Potential long-tail claims based upon past conduct triggering old occurrence based policies
 - Causation issues: What conduct is alleged to have contributed to global warming?
 - Dispensing misleading information a la Tobacco Companies
 - Similar issues to asbestos claims litigation: lost policies, policy limits, number of occurrences, evergreen policies, reinsurance, allocation between insurers, choice of law/jurisdictional issues
 - Even if plaintiffs are unlikely to succeed on the merits, duty to defend may be invoked
- Is “carbon emission” an occurrence?
 - Do allegations contend that wrongful conduct was accidental, or expected and intended?
 - What is the trigger of coverage? Continuous? Exposure? Manifestation? Injury-in-fact?
- Is it possible to adequately allege a causal link between BI/PD from a climate change event and conduct of policyholder?
 - Even if no, duty to defend may be triggered under CGL terms
- Pollution Exclusion (ambiguous as to climate change litigation?)
 - 1973 Pollution Exclusion – are greenhouse gasses “irritants, contaminants or pollutants”?
 - 1986 CERCLA Exclusion – does it preclude claims based upon climate change?

Other Climate Change Related Claims and Coverage

Any Coverage Under a D&O Policy?

- Claims based upon failure to disclose potential liability in public disclosures / SEC filings
 - Liability may be found for losses suffered by a company resulting from the directors' and officers' failure to properly disclose the company's climate change risks or failure to make required governmental or agency disclosures
- Claims against Executives for failure to make contingency plans around climate change stoppages
- Claims against Directors for business relationships with climate affected regions resulting in business interruption/loss of market
- Claims re investment in contributors to climate change
- Government investigations relating to climate change related activities

Business Judgement Rule

- may provide some degree of protection from ultimate liability, but not from the costs of litigating such claims
- Scope of pollution exclusions? BI/PD exclusions? Dishonesty/Fraud exclusions? What does the policy say?
- What representations were made in application for insurance?

“Elevated concentrations of greenhouse gases in the atmosphere may reasonably be anticipated to endanger the public health and to endanger the public welfare of current and future generations.”

- Environmental Protection Agency's (EPA) “Endangerment and Cause or Contribute Findings for Greenhouse Gases under Section 202(a) of the Clean Air Act”, December 12, 2009

Other Climate Change Related Claims and Coverage

- Any likelihood of specialty products?
 - New CC tailored policies to insure against risks particular to climate change?
 - Is reinsurance for CC related contingencies available?
 - Potential for reinsurance by federal government?
 - Absent reinsurance, will capital reserves be sufficient to cover increase of future claims?
 - Global weather insurance?
 - Pollution liability?

Thoughts for Future

- What Can Insurers Do to Prepare For Climate Change Coverage Issues?
 - Review natural disaster risk models to account for increasing climate related loss
 - Measure impact on solvency and investment portfolios
 - Clearly identify what losses are covered in policy and in marketing materials
 - Provide a market specifically for climate related incidents
 - Underwriting/Improved Assessment of Actuarial Risk
- What Can Policy Holders Do to Prepare for Climate Change Coverage Issues?
 - Read Policy and be aware of the scope of coverage available
 - Secure appropriate limits of coverage
 - Create systems to document loss and be able to submit claim in event of electronic systems failure
 - Demand coverage for climate related incidents going forward given the enormous risks involved and the lack of certainty in the law

GLOBAL COVERAGE IMPLICATIONS FROM
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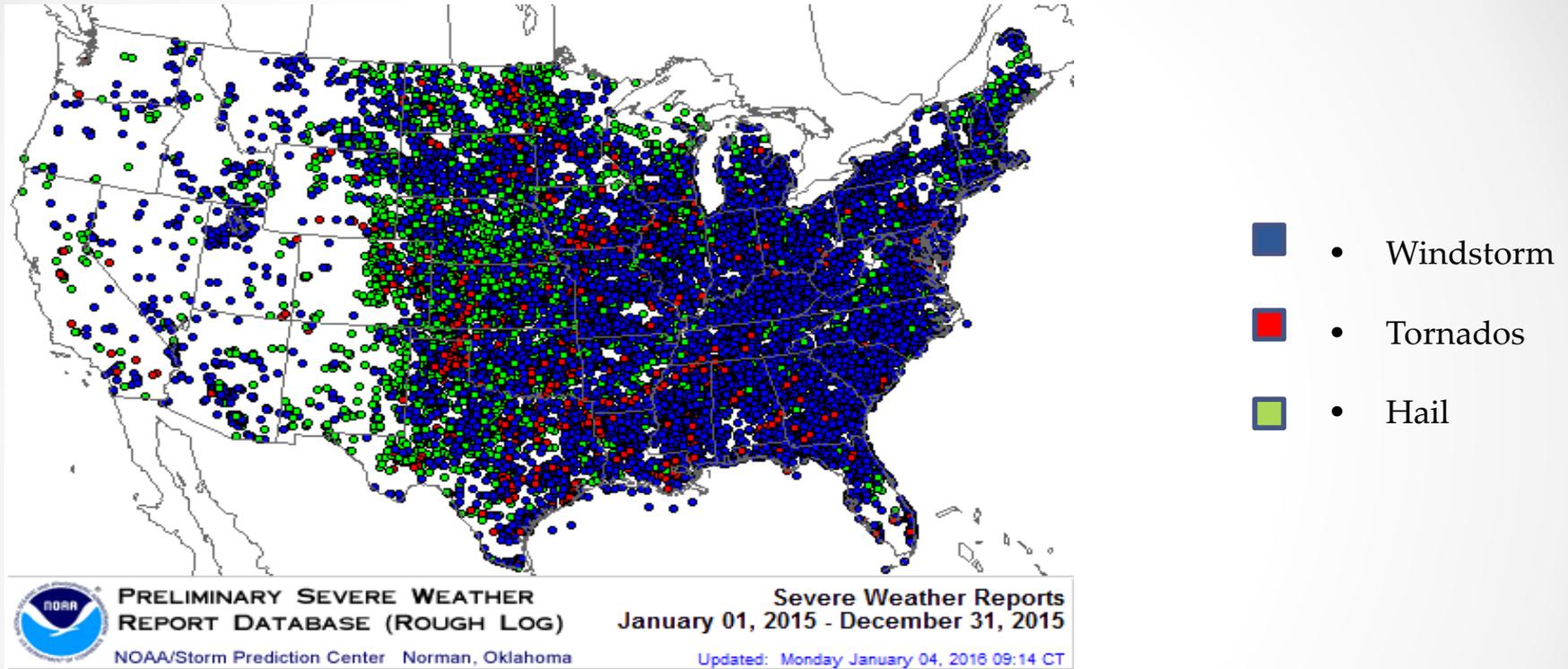
Sedgwick_{LLP}

Increased Reports of Extreme Weather Events

- The number of annual reported tornado occurrences doubled between 1954 and 2003.
- Reports of severe thunderstorms without associated tornadoes increased by a factor of 20 between 1955 and 2004
- Over the last 30 years there has been an increase in the frequency and intensity of reported heavy precipitation events

* CCSP, *Weather and Climate Extremes in a Changing Climate* (2008), p. 76-77

Increased Reports of Extreme Weather Events



Annual Severe Weather Report Summary 2015, http://www.spc.noaa.gov/climo/online/monthly/2015_annual_summary.html

Increased Reports of Extreme Weather Events

Date	Location	Est. Cost of Damage
12/26/15	Garland/Rowlett	\$1,200 million
3/16/16	Fort Worth	\$600 million
3/23/16	Plano	\$700 million
4/11/16	Wiley	\$300 million
4/12/16	San Antonio	\$1,400 million

* Ins

Lawsuit to Claim Ratio - Texas

- Traditionally carriers reported a ratio of 1% or less
- For some this changed in 2012 when ratio arising out of Hidalgo County increased as high as 40%
- Carriers continue to experience ratios far in excess of traditional ratios

Lawsuit Count - Florida

- Based on 2015 data, Florida's homeowners insurers expect lawsuit amounts to at least double over the next twelve months.
 - Heritage Property & Casualty Insurance
 - Heritage's policy count increased by 30% from June 2014 through June 2015
 - Nearly 400% increase in lawsuits during the same period
 - Universal Property & Casualty
 - Universal P&C policy count increased a small percentage between June 2014 and June 2015.
 - 156% increase in lawsuits during the same period

*A Rude Awakening: The 2015 Florida Homeowners Insurance Litigation Alarm, August 2, 2015,
<http://firstpartyproperty.com/blog/a-rude-awakening-the-2015-florida-homeowners-insurance-litigation-alarm/>

Concurrent Causation

- Applies when a loss is brought about by two or more causes
- Issue arises when at least one cause is covered but others are not
- Expansive View of Coverage
 - The loss is covered as long as one of the causes is a covered peril (or not specifically excluded).
 - *State Farm Mut. Auto. Ins. Co. v. Patridge*, 10 Cal. 3d 94, 514 P. 2d 123 (Cal. 1973).
- Restrictive View of Coverage
 - The insured is entitled to recover only that portion of the loss caused solely by the covered peril
 - The insured has the burden to segregate the damage caused by covered peril during the policy period from that not caused by a covered peril or which occurred outside the policy period.
 - *Hamilton Properties v. American Ins. Co.*, 2016 WL 1533931 (5th Cir. April 14, 2016)
- Anti-Concurrent Causation (“ACC”) Clause
 - States no coverage exists where a loss involves a non-covered cause regardless of the sequence
 - Upheld in *JAW The Pointe, LLC v. Lexington Ins. Co.*, 460 S.W. 3d 597, 607 (Tex. 2015)
 - Section 530 of California Ins. Code rejects as long as a covered peril is a “proximate cause” of the loss (not simply a “remote cause”).

Notice Requirements

- Typical policy requires “prompt” notice (“within a reasonable time”)
- Most states require prejudice
 - Florida – presumption of prejudice
 - Texas – carrier must establish prejudice
- How does carrier show prejudice?
 - Delay limited the carriers ability to evaluate the cause and time period of damage
 - *Hamilton Properties v. American Ins. Co.*, 2016 WL 1533931 (5th Cir. April 14, 2016)

Appraisal-Waiver

- Delay must be unreasonable
 - Parties must have reached an impasse (“a mutual understanding that neither will negotiate further”)
 - *In re Universal Underwriters of Tex. Ins. Co.*, 345 S.W. 3d 404, 410 (Tex. 2011)
 - Filing suit does not inherently signal that the parties have mutually concluded that all further settlement negotiations will be futile
 - *In re OOIDA Risk Retention Group, Inc.*, 2015 WL 5223512 (Tex.App.-Fort Worth 2015)
- Delay must cause prejudice
 - Party opposing appraisal must show that the delay in demanding appraisal caused prejudice.
 - “It is difficult to see how prejudice could ever be shown when the policy gives both sides the same opportunity to demand appraisal”
 - *In re Universal Underwriters of Tex. Ins. Co.* at 412
 - Trial court abused its discretion by not compelling appraisal which was demanded more than 16 months after suit was filed and after both parties engaged in discovery and designated experts.
 - *In re Century Surety Co.*, 2015 WL 6689532 (Tex. App. –Amarillo 2015)

Appraisal-Finality

- Does the payment of an appraisal award eliminate:
 - Breach of Contract Claim?
 - Yes, even though insured refused to accept payment of the award
 - *United Neurology, P.A. v. Hartford Lloyd's Ins. Co.*, 101 F. Supp. 3d 584 (S.D. Tex. 2015), *aff'd*, No. 15-20241, 2015 WL 8593311 (5th Cir. Dec. 11, 2015)
 - *Breshears v. State Farm Lloyds*, 155 S.W.3d 340 (Tex. App.-Corpus Christi 2004)
 - Extra-Contractual Claims?
 - Texas: Yes
 - *Breshears v. State Farm Lloyds*, 155 S.W.3d 340 (Tex. App.-Corpus Christi 2004)
 - *United Neurology, P.A. v. Hartford Lloyd's Ins. Co.*
 - But see *Graber v. State Farm Lloyds*, No. 3:13-CV-2671-B, 2015 WL 3755030 at *10 (N.D. Tex. June 15, 2015)
 - Also see *Richardson E. Baptist Church v. Philadelphia Indem. Ins. Co. et. al.*, cause No. 05-14-01491 CV, 2016 WL 1242480 (Tex. App.-Dallas, March 30, 2016, no pet. h.)
 - Florida: No
 - *Blanchard v. State Farm Mutual Automobile Insurance Co.*, 575 So.2d 1289, 1291 (Fla. 1991).

Sever & Abate Extra-Contractual Claims

- *In Re Century Surety*, 2015 WL 6689532 (Tex. App.-Amarillo 2015) held:
 - Where settlement offer has been made, contract and extra-contractual claims cannot be tried together.
 - Solution is to sever and abate (not bifurcation)

Insurer Guidelines and Third Party Bill Reviews: Ethical and Practical Ramifications

- ▶ Presenters:
 - ▶ Douglas M. McIntosh, McIntosh Sawran & Cartaya, P.A., Fort Lauderdale
 - ▶ Neil B. Posner, Much Shelist, PC, Chicago
 - ▶ James R. Sutterfield, Sutterfield & Webb, LLC, New Orleans
- 

Context

- ▶ Issues associated with Billing and Litigation Guidelines, and the use of “Fourth Party” Billing Auditors:
 - Conflicts, Ethics, and Distrust among the members of the Tripartite Relationship
 - Attorney–Client Privilege and Work–Product Concerns

Issue

- ▶ What concerns does the use of Billing & Litigation Guidelines create for:
 - Insurers
 - Insureds
 - Defense Counsel

Issue (cont'd)

- ▶ The next set of slides is an example of language found in a typical “Billing & Litigation Guidelines for Defense Counsel”

Bill and File Review [DRI]

VI.

BILL AND FILE REVIEW

[Insurer] reserves the right to review all charges for services and disbursements pertaining to litigation, including without limitation all charges paid by the insured with respect to such litigation, whether pursuant to self-insured retentions or deductibles under [Insurer's] insurance policies or otherwise. [Insurer] reserves the right to conduct audits and to review the defense file and/or defense bills, consistent with the defense attorney's ethical obligations, and in a manner that will not compromise the attorney-client or work product protection accorded material in the file or communications by and between counsel, the client and [Insurer] or otherwise interfere with any ethical directive governing the conduct of counsel. Counsel agrees to comply with all reasonable requests for information and documents, provided that such documents or information are not privileged or intended by the insured to be confidential. In such instance, the [Insurer] must obtain the consent of the Insured. [Insurer] fully reserves all rights to decline to pay or to seek reductions and/or refunds with respect to charges that fail to comply with the requirements set forth herein, and which are not fully explained or documented by the firm after reasonable inquiry. The [Insurer] shall allow the law firm to appeal any declination of payment by [Insurer]. [Insurer] agrees to pay the undisputed portion of bills received from Counsel Counsel within _____ days.

Incorporating DRI's Recommended Guidelines

Consistent with DRI's policy, we have also included an addendum that specifies our business policies relative to reimbursement of expenses, payment of professional fees and other administrative matters. Please familiarize yourself with the guidelines and the addendum. Communicate them to all other counsel and staff in your office who may be involved in the defense, billing or administration of our customers' matters.

We look forward to collaborating with your firm in utilizing the DRI's Recommended Claim Case Handling Guidelines for Insurers, to serve the legal needs of our policyholders. Please feel free to contact one of our claims professionals with any questions you may have.

The “Disclaimer”

Example 1

2. **Defense Counsel’s Ethical Responsibility**

- 2.1. The defense counsel’s ethical duty is always to the client (s) and these Guidelines must be construed in accordance with the Defense Counsel’s ethical obligations in the applicable jurisdiction.
- 2.2. Retained counsel has an ethical duty to represent the insured’s interests and any conflict should be resolved in favor of the insured.

Example 2

Nothing in this document is intended to interfere with counsel's obligation to provide independent legal judgment in representing the Insured. Rather, it is our desire to make the claims specialist a part of that decision-making process.

Experts

Example 1

2. Expert Witnesses

Expert witnesses, including medical witnesses, shall not be engaged without the claims specialist's prior approval. Charges for the use of investigators, experts or other consultants deemed inappropriate by the claims specialist and incurred without the claims specialist's prior consent shall not be payable by [REDACTED]. It is the responsibility of counsel to review and approve all fees and expenses of the expert prior to submission to the claims specialist. Medical examinations will be arranged by the claims specialist, unless otherwise authorized.

Example 2

c) Expert and investigator expenses - Counsel should discuss with the assigned claim professional all anticipated expenses to be incurred by experts. Requests for the use of an expert should be accompanied by a proposal setting forth the following information:

- The purpose for the expert's involvement;
- The nature of any examinations, tests, studies or other activities the expert will undertake;
- A detailed budget for the proposed service;
- The corresponding rates and payment terms the expert expects; and
- The expert's current curriculum vitae.

We Will Not Pay For...

D. Fees And Expenses Which Will Not Be Compensated

We will not pay for:

- attorney or firm fees or expenses that are not reasonable, necessary, and specifically related to the matter at hand;
 - attorney or firm fees that are not in compliance with these guidelines;
 - experts or discovery (without prior claim handler approval);
- 

Parties to the Tripartite Relationship, their Duties & Objectives

- ▶ Insurer
 - ▶ Insured
 - ▶ Defense Counsel
 - ▶ Fourth-Party Billing Auditor
- 

Common and Adverse Interests

- ▶ Insurer and Insured
 - ▶ Insurer and Defense Counsel
 - ▶ Defense Counsel and Fourth-Party Auditor
- 

How the Adverse Interests Play Out

- ▶ Attorney–Client Privilege and Work Product
 - Does disclosure of information to the insurer waive these privileges?
 - The “Magic Circle”
 - *U.S. v. MIT*, 129 F.3d 681 (1st Cir. 1997)
 - *U.S. v. Kovel*, 296 F.2d 918 (2d Cir. 1961)

How the Adverse Interests Play Out

- ▶ Attorney–Client Privilege and Work Product
 - Does disclosure of information to the insurer waive these privileges?
 - The impact—if any—on whether you’re in a “one–client” or a “dual–client” jurisdiction.
 - *Purdy v. Pacific Auto. Ins. Co.*, 203 Cal. Rptr. 524 (Ct. App. 1984)
 - *Mass. Elec. Co. v. Fletcher, Tilton & Whipple, P.C.*, 394 Mass. 265 (1985)

How the Adverse Interests Play Out

- ▶ Attorney–Client Privilege and Work Product
 - Does disclosure of information to the “fourth party” auditor waive these privileges?
 - Most likely: Yes.
 - *U.S. v. MIT*, 129 F.3d 681 (1st Cir. 1997) (privileged information disclosed to an outside government auditing service was discoverable)
 - *In re Rules of Prof. Conduct & Insurer Imposed Billing Rules & Procedures*, 2 P.3d 806 (Mont. 2000) (third-party billing auditors not part of “magic circle”)
 - *U.S. v. S. Chicago Bank*, 1998 WL 774001 (N.D. Ill. 1998) (drawing distinction between “fraud auditors” and “outside ‘year-end’ auditors”)

How the Adverse Interests Play Out

▶ Prof. Responsibility and Conflicts

- Do “Litigation & Billing Guidelines” create conflicts of interest?
 - In many cases: Yes.
 - Implicated Model Rules:
 - 1.4 (Communication)
 - 1.6 (Confidentiality)
 - 1.7 (Conflict of Interest—Current Clients)
 - 1.8(f) (Conflict of Interest where fees are being paid by someone other than the client)
 - 5.4 (Professional Independence of a Lawyer)
 - 5.5 (Unauthorized Practice of Law) (esp. applicable where a fourth-party auditor is involved)
 - 5.7 (Responsibilities regarding law-related services)
 - 8.4 (Misconduct)

Risks

- ▶ Disclosure to fourth-party auditors—indeed, to anyone outside the “magic circle”—likely will vitiate the privileges

Risks (cont'd)

- ▶ Billing & Litigation Guidelines potentially impose limitations on defense counsel's independent professional judgment, leading to conflicts of interest that may be unwaivable
 - Case Law: *Frederick v. Unum Life Ins. Co. of Am.*, 180 F.R.D. 384 (D. Mont. 1998) (held: insurer's "Guide for Outside Counsel" was in conflict with local rules of practice and F. R. Civ. P.)

Risks (cont'd)

- ▶ Billing & Litigation Guidelines potentially impose limitations on defense counsel's independent professional judgment, leading to conflicts of interest that may be unwaivable
 - Ethics Opinions:
 - *Iowa S. Ct. Bd. Of Prof. Ethics & Conduct Op. No. 99-01 (Sept. 8, 1999)*
 - *Tenn. Ethics Op. 99-F-143, 1999 WL 406886 (June 14, 1999)*
 - *Tenn. Ethics Op. 99-F-143(a), 1999 WL 961452 (Sept. 10, 1999)*

Potential Remedies?

- ▶ Food-for-thought ideas:
 - Stop using fourth-party auditors?
 - Obtain informed consent of insured before disclosing detailed invoices to outside auditors?
 - At policy inception, give insured the option to choose in-house auditors versus outside auditors (at higher premium)?
 - Go to fixed-fee arrangements?

Case for Fixed-Fee Arrangements

- ▶ Simple: There's nothing to audit!
 - ▶ Not So Simple: Where insurer accepts defense under a reservation of rights, the result of which under state law is that insured gets independent counsel, what would encourage independent counsel to agree to a fixed-fee arrangement?
- 

A Call To Arms!

- ▶ We know the problem:
 - Conflicts of interest abound
 - Privilege is at risk
 - The tension between defense counsel and insurers is palpable
 - Billing & Litigation Guidelines may be found to interfere with defense counsel's independent professional judgment
 - Insurers still want, and need to, control costs
 - And insureds want a solid defense
 - Everyone is upset!
- 

A Call To Arms!

▶ It's Up To Us!

- The law is reactive. It responds to problems in the context of an adversary system.
 - We can be prescriptive.
 - We can do better.
 - Collectively, let's come up with a better system.
- 

Q&A

- ▶ And thanks!

Issues Arising After Breach of the Duty to Defend

John S. Vishneski III, Reed Smith LLP
Janet R. Davis, Cozen O'Connor

So, the Court held the insurer breached its duty to defend....

Now
what?



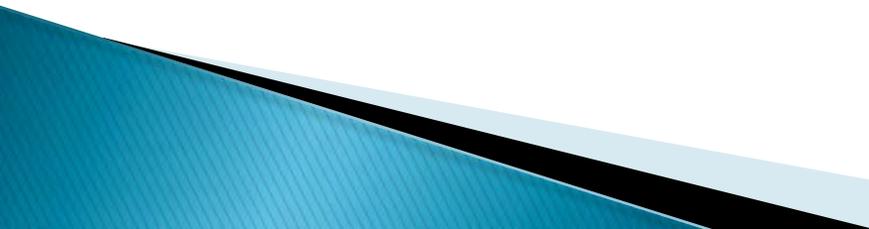
Summary of Issues

- ▶ **Extinguishing the Duty to Defend**
 - Under what circumstances may an insurer unilaterally withdraw from a defense?
- ▶ **Estoppel Doctrine**
 - Does the breach bar the insurer from arguing that there is no coverage?
- ▶ **Reasonableness of Defense Fees**
 - May the insurer challenge the insured's defense fees and costs?



Extinguishing the Duty to Defend

Extinguishing the Duty to Defend: Hypothetical

- ▶ Insured sued for unlawful termination and negligence
 - ▶ Insurer defends under reservation of rights noting that only negligence claim is potentially covered
 - ▶ Summary judgment granted for defendant on negligence claims in underlying case
 - ▶ Insurer withdraws defense, citing no potentially covered claims left in the case
- 

Breach?



Answer: It Depends

- ▶ No breach of the duty to defend where remaining claims not “reasonably susceptible” to interpretation falling within coverage.

–Conway Chevrolet Buick, Inc. v. Travelers Indemn. Co., 136 F.3d 210 (1st Cir. 1998)

- ▶ Was a breach where insurer withdrew after summary judgment because duty continues until all rights to appeal exhausted.

–Wells’ Dairy, Inc. v. Travelers Indemn. Co. of Ill., 336 F. Supp. 2d 906 (N.D. Iowa 2004)

Extinguishing the Duty to Defend: Exhaustion of Policy Limits

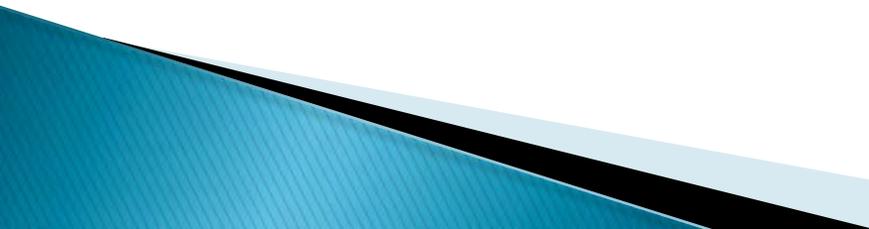
- ▶ Courts have held that insurer is not relieved of duty to defend even after tendering policy limits





Disputing Coverage after a Breach: The Estoppel Doctrine

Disputing Coverage after a Breach: Three Approaches

- ▶ Rejection of Estoppel Doctrine: Carrier can raise coverage defenses
 - ▶ Estoppel Doctrine: Carrier barred from raising coverage defenses
 - ▶ Limited Estoppel Doctrine: Carrier may raise coverage defenses unless it acted wrongfully/unreasonably
- 

Rejection of Estoppel Doctrine: Insurer May Raise Coverage Defenses

- ▶ Applied in Majority of Jurisdictions
- ▶ Rationales:
 - Breach of contract should be remedied by monetary damages only, i.e. payment of defense fees
 - Breach should not alter the terms of the contract
 - Results in improperly applying broad duty to defend standard to duty to indemnify
 - Improperly punitive

Automatic Estoppel Doctrine: Insurer May Not Raise Coverage Defenses

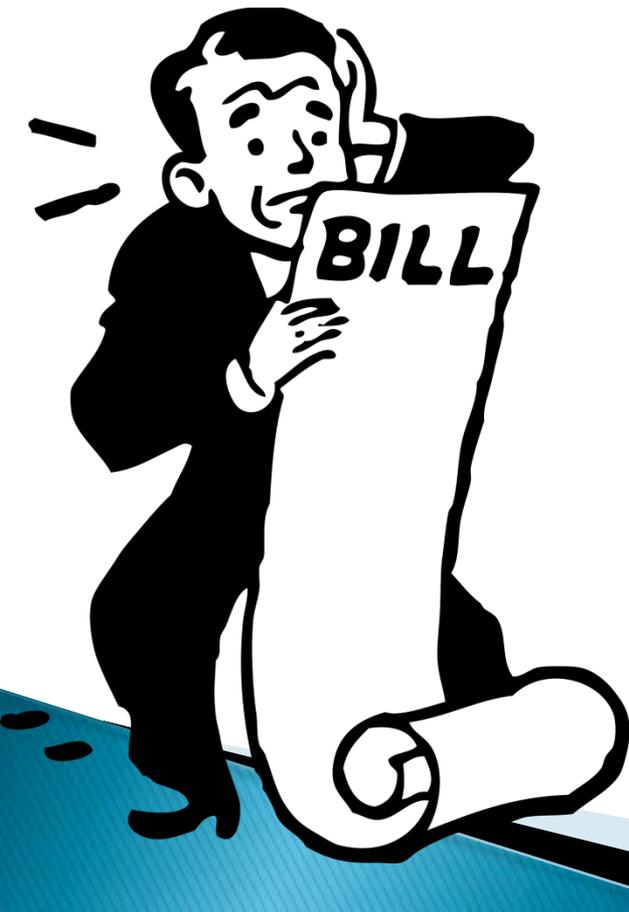
▶ Rationales:

- Equitable remedy needed to compensate for loss of non-monetary benefit
- Necessary in jurisdictions that limit bad faith damages
- Provides deterrent against breaching duty to defend

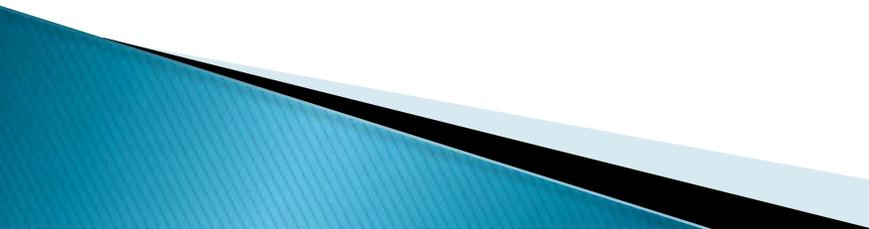
Limited Estoppel Doctrine

- Applied in few states, including California and Washington
- Holds that insurer estopped from raising coverage defenses only if it acted in bad faith or unreasonably

Challenging Underlying Attorneys' Fees



Challenging Underlying Attorneys' Fees

- ▶ Most jurisdictions allow a breaching insurer to challenge the reasonableness of the underlying attorneys' fees
 - ▶ Some states impose a burden-shifting scheme: presumption that the fees were reasonable and shifting burden to carrier to prove unreasonable
- 

Affixed as Appendix A hereto and made a part of this D&O Coverage Section is a list of Panel Counsel Firms from which a selection of legal counsel shall be made to conduct the defense of any Securities Claim against an Insured pursuant to the terms set forth in this Clause. In the event the Insurer has assumed the defense, then the Insurer shall select a Panel Counsel Firm to defend the Insureds. In the event the Insureds are already defending a Securities Claim, then the Insureds shall select a Panel Counsel Firm to defend the Insureds.

Hypothetical

- An insurer offers a D&O insurance policy (“Policy”) which indemnifies the policyholder as an entity for “loss” defined to include the cost of defense in excess of a \$1,000,000 retention for securities claims.
- The Policy provides: “The insureds shall defend and contest any claim made against them. The insurer does not assume any duty to defend or investigate.”
- The Policy requires the policyholder to use Panel Counsel Firms and individual lawyers as a condition of coverage.

Hypothetical

- To be listed in the Policy, all Panel Counsel Firms have been required to orally agree (a) that no lawyer in their firm will represent any client in any coverage matter adverse to the insurer; or (b) that no lawyer in their firm will represent any client asserting a bad faith claim against the insurer, even if completely unrelated to matters covered by the Policy (“non-adversity agreements”).
- Prior to sale and issuance of the Policy, the insurer does not disclose to its policyholder customers the non-adversity agreements it has required from listed panel counsel.

Questions

1. Has the insurer breached any duty of disclosure to its policyholder customers prior to the sale and issuance of the Policy?
2. If so, do panel counsel have any exposure from acceding to being listed by the insurer without disclosure to prospective policyholder customers of their non-adversity agreement?
3. Are there any other legal or ethical issues implicated?

Potential Conflicts

It is commonly understood that there are at least three areas where the interests of the policyholder and the insurer potentially diverge:

1. The policyholder is interested in having all asserted claims completely covered, whereas the insurer may contest coverage or reserve its rights regarding a denial or allocation of coverage for some or all of the claims alleged.
2. The policyholder is interested in having all claims resolved within the limits of the Policy, whereas the insurer may resist settlement of claims for amounts it deems unreasonable within Policy limits.
3. The policyholder may want to defend against baseless claims for reputational or other business reasons rather than settle them, whereas the insurer may insist upon settlement within the self insured retention.

Rule 1.7 of the Illinois Rules of Professional Conduct provides:

CONFLICT OF INTEREST: CURRENT CLIENTS

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) *there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.*

Rule 1.7 of the Illinois Rules of Professional Conduct provides:

CONFLICT OF INTEREST: CURRENT CLIENTS

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; **and**

(4) *each affected client gives informed consent.*

Comment 9 to Rule 1.7 of the Illinois Rules of Professional Conduct elaborates:

Lawyer's Responsibilities to Former Clients and Other Third Persons:

[9] In addition to conflicts with other current clients, ***a lawyer's duties of loyalty and independence may be materially limited*** by responsibilities to former clients under Rule 1.9 or ***by the lawyer's responsibilities to other persons***, such as fiduciary duties arising from a lawyer's service as a trustee, executor or corporate director.



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OTHER CLAIMS

Pattern and Practice



Building the Basis for Discovery



Picking A Theory/Basis

- Pattern or practice
- Inconsistent coverage positions
 - **Ambiguity**
 - Discrimination
- Improper coverage decisions
 - Use of opinions in other claims to decide the one at hand
- Mental state/exemplary damages
- Bad faith
 - Lack of reasonable basis based on inconsistency
 - Pretext
 - Use of experts in other cases
 - Cookie cutter opinions
 - Result-oriented
 - Frequency



General Sources

- Similar claims
 - Geographic
 - Temporal
 - Topic
 - Adjuster
 - Supervisor
- Other Coverage Litigation
 - Excess/primary inconsistencies
 - Subrogation
 - Other bad faith claims
 - Pending suits
 - Verdicts



The Claim Itself

- Individual adjuster collections of prior coverage opinions in other cases
- Other similar coverage cases being handled by the adjuster
- The same adjuster may use a coverage opinion from one case to decide a coverage issue in another case coverage issue.
- Company coverage data banks of prior coverage opinions
- Litigation information/statistics kept by corporate management
- Records relating to significant national coverage questions
- Subrogation cases where the company may have taken a contrary position
- Underwriting files
- Claims liaison files
- "Shadow" files kept by supervisors
- The files of outside coverage counsel



Tactics

- Request documents first
 - Get the carrier committed
 - Tailor and limit the requests to anticipate "over-breadth" objections
- Establish sources of information from depositions of claims personnel
- Be prepared to depose a corporate representative knowledgeable of report and search capacities
- Have a well-defined target and theory for use of the information
 - Seeking to compare valuation methods alone will not succeed



Basic Objections



Scope of Discovery

- Amendments to Federal Rules of Civil Procedure
 - Old rule: “Reasonably calculated to lead to the discovery of admissible evidence”
 - New rule: Must be “relevant to any party's claims or defense and proportional to the needs of the case”

The Claim Stands On Its Own

- A person's claim stands on its own merits; different treatment of someone else doesn't change that. (Rule 401 relevance)
 - "Past claims by other insureds are not relevant to the present bad faith action before the court." *Adams v. Allstate Ins. Co.*, 189 F.R.D. 331, 333 (E.D. Pa. 1999). *Adams v. Allstate Ins. Co.*, 189 F.R.D. 331, 333 (E.D. Pa. 1999).
 - "[W]e fail to see how [insurer's] overpayment, underpayment, or proper payment of the claims of unrelated third parties is probative of its conduct with respect to [insured's] undervaluation at issue in this case." *In re National Lloyds Ins. Co.*, 2014 WL 5785871 (Tex. 2014).
- "Evidence of a person's character or character trait is not admissible to prove that on a particular occasion the person acted in accordance with the character or trait." Fed. R. Evid. 404(a)(1).
- "Evidence of a crime, wrong, or other act is not admissible to prove a person's character in order to show that on a particular occasion the person acted in accordance with the character." Fed. R. Evid. 404(b)(1).
- But, Rule 406 states: "Evidence of a person's habit or an organization's routine practice may be admitted to prove that on a particular occasion the person or organization acted in accordance with the habit or routine practice. The court may admit this evidence regardless of whether it is corroborated or whether there was an eyewitness."



Fleshing Out Relevance

- Relevance (Rule 401)
 - Claims vary greatly
 - Different policies, claims handlers, applicable law
 - Danger of mini-trials over other claims
 - Tailoring and limiting— make it fit the case. *Allstate Ins. Co. v. Scrogan*, 851 N.E.2d 317 (Ind. Ct. App. 2006)
 - Time periods
 - Geographic limits
 - Nature of claim
 - Claims handler
- Dissimilar and out-of-state acts and claims-handling have “little bearing” on recoverable punitive awards. *State Farm v. Campbell*, 538 U.S. 408 (2003).
- Evidence insufficient to show a pattern



Over-breadth and Burden

- Breadth of request impacts burden
- Tailoring is critical for the policyholder
- Requiring tailoring is critical for the carrier
- May require manual review of voluminous data
- Redaction
- The objection must be supported with proof
 - Insurer affidavit demonstrating expense
 - Include specifics



Other Settlements

- Inquiries into other settlements potentially run afoul of Rule 408
 - Cannot use an offer or settlement to "prove or disprove the validity or amount of a disputed claim"
- Bifurcation of contract and extra-contractual claims used to limit discovery of other claims during the contract phase



Other Objections/Considerations

- Other claims involve other persons and entities not involved in extant litigation
 - Confidentiality
 - Privacy
 - Trade secrets
- Carrier considerations
 - Privacy of claims handlers (personnel files)
 - Trade secrets of carrier
- Attorney client and work product privileges
- Policyholder approach
 - Tailor/limit
 - Redact
 - Use confidentiality agreements to avoid confidentiality issues



In re National Lloyds

Lack of Focused Attack or Basis



In Re National Lloyds Insurance Company, 2014 WL 5785871 (Tex. 2014)

- Discovery sought
 - Other claim files from similar claims in the same neighborhood
- Basis
 - Might show underpaid plaintiff's claim
- Carrier position
 - Gospel according to Matthew
 - The parable of the generous employer
 - Attack on any discovery of similar claims
 - Purported epidemic of patterned, cookie-cutter bad faith claims and expensive discovery



In re National Lloyds

- Holding:
 - [W]e fail to see how National Lloyds' overpayment, underpayment, or proper payment of the claims of unrelated third parties is probative of its conduct with respect to Erving's undervaluation claims at issue in this case.



In re National Lloyds

- Holding
 - Scouring claim files in hopes of finding similarly situated claimants whose claims were evaluated differently from Erving's is at best an “impermissible fishing expedition.” Sanderson, 898 S.W.2d at 815. Without more, the information sought does not appear reasonably calculated to lead to the discovery of evidence that has a tendency “to make the existence of any fact that is of consequence to the determination of the action more probable or less probable.” TEX. R. EVID. 401; TEX. R. CIV. P. 192.3(a).



Future—Limited Holding

- "We ***do not hold*** that evidence of third-party insurance claims ***can never be relevant*** in coverage litigation. We simply hold that, in this case, on this plaintiff's allegations, there is at best a remote possibility that such claims could lead to the discovery of admissible evidence. That possibility is not sufficient to render the claims discoverable under Rule 192.3(a)"

In re National Redux

- In re *National Lloyds Ins. Co.*, 2015 WL 3751701 (Tex. App.—Corpus Christi 2015, no pet.)
- Multi-district litigation
- ***Wrongful acts occurred with "such frequency that they constitute[d] a general business practice."***
- Depo after doc request showed documents not produced
- Sought management reports on
 - Generalized assessment, review, evaluation and/or summary of defendant's handling of claims
 - Total amount paid on claims,
 - time open,
 - responsiveness,
 - compliance with company policies and procedures,
 - compliance with Texas Insurance Code,
 - the number of reopened claims and the reason for reopening the claim, and the total amount paid on reopened claims.



In re National

- Distinguished supreme court decision in *In re National*
- Discovery directly related to the hail claims at issue
- Inconsistencies between deposition and affidavit of claims adjuster regarding burdensomeness
- Discovery ordered.



Other Jurisdictions



Cactus/Oklahoma—Anecdotal

- *Cactus Drilling Corp. v. National Union Fire Ins. Co.*, et al., 5:12-CV-00191-M, Order on Motion for Protection and to Quash (10-3-13) [Doc. 208] (Okla. W.D.)
- Evidence other primary carriers paid
- Evidence other excess carriers paid
- Motivation
 - Avoid allegation of selling illusory coverage
- Evidence the defendant had paid and defended on primary policies
- Same as to excess/umbrella
- Evidence an opinion in another case was used to decide coverage in the Cactus case
- Use of same denial letter

Caselaw In Oklahoma

- *Vining v. Enterprise Fin. Group*, 148 F.3d 1206, 1218–19 (10th Cir. 1998) (holding that the claims files for similar claims were discoverable)
- *Broadway Park, L.L.C. v. Hartford Cas. Ins. Co.*, 2006 U.S. Dist. LEXIS 55914, at *4–5 (W.D. Okla. Aug. 9, 2006) (Miles-LaGrange, J., opinion) (citing *Vining* for the rule that “evidence of an insurance company's general business practices is relevant in a bad faith case”)
- *Sullivan v. USAA Gen. Indemn. Co.*, 2006 U.S. Dist. LEXIS 32670, at *6–7 (W.D. Okla. May 10, 2006) (Miles-LaGrange, J., opinion) (other claims were discoverable where the same software and adjuster were used in adjusting the plaintiff's claim and other claims in years past)
- *Metzger v. Am. Fid. Assur. Co.*, 2007 U.S. Dist. LEXIS 90235 (W.D. Okla. Dec. 7, 2007) (“[E]vidence regarding [similar] policies within the state of Oklahoma is relevant and is therefore, admissible.”)

Holding

- "[T]he Court finds the documents requested are relevant to plaintiff's breach of contract and bad faith claims as they bear directly on whether the policy's language at issue is clear and unambiguous as defendants assert and may also show that Chartis has held coverage positions that are not advanced by the original drafters of the policy at issue."
- Discoverable re breach of contract
 - Reasonableness of interpretations
- Failure to properly investigate and evaluate
- Bad faith
 - Knowledge coverage available because paid prior claims
 - Failed to pay this claim

Stipulated Settlements: Under What Circumstances Can the Insured Bind the Insurer for Bad Faith

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A Preview:

1. What are Consent Agreements?
2. When Can Someone Sign a Consent Agreement?
3. Can you sign one when a defense afforded under a ROR?
4. What happens if a dec action is filed?
5. What happens if a demand is made within policy limits?
6. Can I reject the defense and sign one?
7. What if I give company the option to participate?
8. What happens if there is excess coverage involved?
9. After a consent judgment what defenses does an insurer have?

What are Consent Agreements?

- Stipulated Judgment
- Establishes Liability
- Establishes Damages
- Agreement not to execute
- Assignment of rights



A Rose By Any Other Name.....

In the beginning

- *Metcalf v. Hartford Acc. & Indem. Co.*, 176 Neb. 468, 476, 126 N.W.2d 471, 476 (Neb. 1964)

Florida:

- Coblantz Agreements: *Coblantz v. Am. Sur. Co. of New York*, 416 F.2d 1059 (5th Cir. 1969) (applying Florida law).

Arizona:

- Damron or Morris Agreement: *Damron v. Sledge*, 460 P.2d 997 (Ariz. 1969); *USAA v. Morris*, 741 P.2d 246 (Ariz. 1987).

Missouri:

- "065 Agreements": § 537.065, Mo. Stat.



A Rose By Any Other Name.....

Minnesota & North Dakota:

- Miller-Shugart Agreements: *Miller v. Shugart*, 316 N.W.2d 729 (Minn. 1982).

Colorado:

- Basher Agreements : *Northland Ins. Co. v. Bashor*, 177 Colo. 463, 494 P.2d 1292 (Colo. 1972).

Other states:

- "Covenant Judgments": *Bird v. Best Plumbing Grp., LLC*, 766, 287 P.3d 551, 556 (Wash. 2012).



When Can Someone Sign a Consent Agreement?

Majority:

- When claim covered
- AND insurer wrongfully refuses to defend



Can you sign one when defense afforded under a ROR?

Arizona?

- YES: USAA v. Morris, 154 Ariz. 113, 741 P.2d 246, 249 (Ariz. 1987)

Maine?

- YES (after notice): Patrons Oxford Insurance Co. v. Harris, 905 A.2d 819 (Me. 2006).

Washington?

- YES: Martin v. Johnson, 141 Wash. App. 611, 170 P.3d 1198 (Wash. 2007)



Can you sign one when defense afforded under a ROR?

Texas?

- Arguably, YES. Lennar Corp. v. Markel American Ins. Co., 413 S.W.3d 750 (Tex 2013)

Louisiana?

- NO. Danrik Const. Inc. v. Am. Cas. Co. of Reading Pennsylvania, 314 F. App'x 720 (5th Cir. 2009) (applying Louisiana law) (unpublished).

Alabama?

- NO. L & S Roofing Supply Co. v. St. Paul Fire & Marine Ins. Co., 521 So. 2d 1298, 1304 (Ala. 1987)



What About a ROR & Demand Within Policy Limits?

Iowa?

- YES: Kelly v. Iowa Mutual, 620 N.W. 2d 637 (Iowa 2000).

Wyoming?

- YES, if notice is given: Gainsco Ins. v. Amoco Product, 53 P.3d 1051 (Wyo. 2002).



Can I reject the defense under a ROR and sign?

Even in states where I cannot with ROR?

Florida?

- YES, if defense is actually rejected: *Taylor v. Safeco Insurance Co.*, 361 So. 2d 743 (Fla. 1st DCA 1978); *Aguero v. First American*, 927 So. 2d 894 (Fla. 3d DCA 2005).

Pennsylvania?

- YES: *Babcock & Wilcox Co. v. Am. Nuclear Insurers*, 2013 PA Super 174, 76 A.3d 1, 18 (2013) *appeal granted in part*, 84 A.3d 699 (Pa. 2014).

Missouri?

- YES: *Central Bank v. St. Paul Fire & Marine Ins.*, 929 F.2d 431 (8th Cir. 1991) (applying Missouri law); *Butters v. City of Independence*, 513 S.W.2d 418 (Mo. 1974).



Can I reject the defense under a ROR and sign?

Even in states where I cannot with ROR?

Massachusetts?

- YES: *Three Sons, Inc. v. Phoenix Ins. Co.*, 357 Mass. 271, 257 N.E.2d 774 (Mass. 1970).

Kentucky?

- YES: *Medical Protective Co. of Fort Wayne, Indiana v. Davis*, 581 S.W.2d 25 (Ky. Ct. App. 1979) (applying Kentucky law).

Alaska?

- YES: *Cont'l Ins. Co. v. Bayless & Roberts, Inc.*, 608 P.2d 281 (Alaska 1980)



What if I give company the option to participate?

California?

- Yes: *Wright v. Fireman's Fund Ins. Companies*, 11 Cal. App. 4th 998, 14 Cal. Rptr. 2d 588 (Cal. App. 1992).

Ohio?

- YES: *Romstadt v. Allstate Ins. Co.*, 844 F. Supp. 361 (N.D. Ohio 1994) *aff'd*, 59 F.3d 608 (6th Cir. 1995) (applying Ohio law).



What happens if there is excess coverage?

...while being defended by underlying policy

Arizona?

- NO: *Regal Homes, Inc. v. CNA Ins.*, 217 Ariz. 159, 167-68, 171 P.3d 610, 618-19 (Arizona Ct. App. 2007)

Florida?

- NO: *U.S. Fire Ins. Co. v. Mikes*, 576 F. Supp. 2d 1303, 1325 (M.D. Fla. 2007) *aff'd sub nom. U.S. Fire Ins. Co. v. Freedom Vill. of Sun City Ctr., Ltd.*, 279 Fed. Appx. 879 (11th Cir. 2008)

Washington?

- NO: *Rees v. Viking Ins. Co.*, 77 Wash. App. 716, 719, 892 P.2d 1128, 1130 (Wash App. Ct. 1995)

California?

- NO: *Travelers Cas. & Sur. Co. v. Am. Int'l Surplus Lines Ins. Co.*, 465 F. Supp. 2d 1005, 1028 (S.D. Cal. 2006)



What happens if there is excess coverage?

...while being defended by underlying policy

Kansas?

- NO: *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 261 Kan. 806, 829, 934 P.2d 65, 81 (Kan. 1997)

Louisiana?

- NO: *XL Specialty Ins. Co. v. Bollinger Shipyards, Inc.*, 954 F. Supp. 2d 440, 445 (E.D. La. 2013)

What if excess is an indemnity-only policy?

- Yes: *Perera v. U.S. Fid. & Guar. Co.*, 35 So. 3d 893 (Fla. 2010).



Judgment Entered . . . Now What?

. . . what defenses does an insurer have?

Defenses?

- Unreasonableness
- Collusion – absence of arms length
- Fraud
 - *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 261 Kan. 806, 934 P.2d 65 (Kan. 1997)
 - *Detroit Edison Co. v. Michigan Mut. Ins. Co.*, 102 Mich. App. 136, 301 N.W.2d 832 (Mich. App. 1981)



Judgment Entered . . . Now What?

. . . what defenses does an insurer have?

Why, if left “to own devises”?

- Insured can protect themselves
- But, does not have carte blanche over the insurer’s checkbook
- How can insured avoid?
 - Reasonableness hearing
 - Texas: *State Farm Fire & Cas. Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996)
 - Montana: *Tidyman's Mgmt. Servs. Inc. v. Davis*, 2014 MT 205, 376 Mont. 80, 330 P.3d 1139 (Mont. 2014).



How Can You Prove Defenses?

- Both *objective* and *subjective* factors considered
- Prudent Person standard
- Has insured made an effort to “minimize his/her liability”?
 - *Fireman's Fund Ins. Co. v. Sec. Ins. Co. of Hartford*, 72 N.J. 63, 71, 367 A.2d 864 (N.J. 1976)
 - *Taylor v. Safeco Ins. Co.*, 361 So. 2d 743 (Fla. 1st DCA 1978)
- Can comparative neg. be considered?
 - YES:
 - *Alton M. Johnson Co. v. M.A.I.Co.*, 463 N.W.2d 277 (Minn. 1990)
 - *Mid-Continent Cas. Co. v. Am. Pride Bldg. Co., LLC*, 534 F. App'x 926, 927-28 (11th Cir. 2013)



How Can You Prove Defenses?

... comparative negligence

Why, if can't re-try case?

- Factors courts consider for reasonableness:
 - The releasing person's damages;
 - The merits of the releasing person's liability theory;
 - The merits of the released person's defense theory;
 - The released person's relative fault;
 - The risks and expenses of continued litigation;
 - The released person's ability to pay;
 - Any evidence of bad faith, collusion, or fraud;
 - The extent of the releasing person's investigation & preparation of case;
 - The interests of the parties not being released.

Besel v. Viking Ins. Co. of Wisconsin, 49 P.3d 887, 891 (Wash. 2002); *Bond Safeguard Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, No. 6:13-CV-561-ORL, 2014 WL 5325728 (M.D. Fla. Oct. 20, 2014).



How Can You Prove Defenses?

... comparative negligence

Reasonableness of settlement agreement determined by *degree of probability of the insured's success & size of the possible recovery*. Including:

- The extent of the defendant's liability,
- The reasonableness of the damages in comparison with other cases

Chomat v. Northern Insurance Co. of New York, 919 So. 2d 535, 538 (Fla. 3d DCA 2006)

Can NOT assert defenses which could have been asserted in tort action

- *Fireman's Fund Ins. Co. v. Imbesi*, 361 N.J. Super. 539, 826 A.2d 735 (N.J. App. Div. 2003);
Wright v. Hartford Underwriters Ins. Co., 823 So. 2d 241 (Fla. 4th DCA 2002).



How Can You Prove Defenses?

... comparative negligence

CAN use facts from tort as evidence of:

- **unreasonable amount,**
- **fraud, collusion, or**
- **no effort to minimize liability**

Bond Safeguard Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., No. 6:13-CV-561-ORL, 2014 WL 5325728 (M.D. Fla. Oct. 20, 2014).

If Unreasonable or Collusive, Now What?

Does Carrier Pay What IS Reasonable?

Arizona?

- YES: *United Servs. Auto Ass'n v. Morris*, 154 Ariz. 113, 741 P.2d 246 (Ariz. 1987)

Florida?

- NO: *Florida Mid-Continent v. American Pride*, 534 Fed. Appx. 926 (11th Cir. 2013)

Minnesota?

- NO: *Alton M. Johnson Co. v. M.A.I. Co.*, 463 N.W.2d 277 (Minn. 1990); *Corn Plus Cooperative v. Continental Casualty*, 516 F. 3d 674 (8th Cir. 2009).

If Unreasonable or Collusive, Now What?

Does Carrier Still Owe Policy Limit?

Florida?

- YES: *Mobley v. Capitol Specialty Ins.*, 2013 U.S. Dist. LEXIS 101329 (S.D. Fla. 2013)

Minnesota?

- YES: *Miller v. Shugart*, 316 N.W.2d 729 (Minn. 1982)

Texas?

- YES: *Wilcox v. American Home Assur. Co.*, 900 F. Supp. 850 (S.D. Tex. 1995)

Stipulated Settlements: Under What Circumstances Can the Insured Bind the Insurer for Bad Faith

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Damages in the Age of Regulation: The Murky Void Between Compensation and Punishment

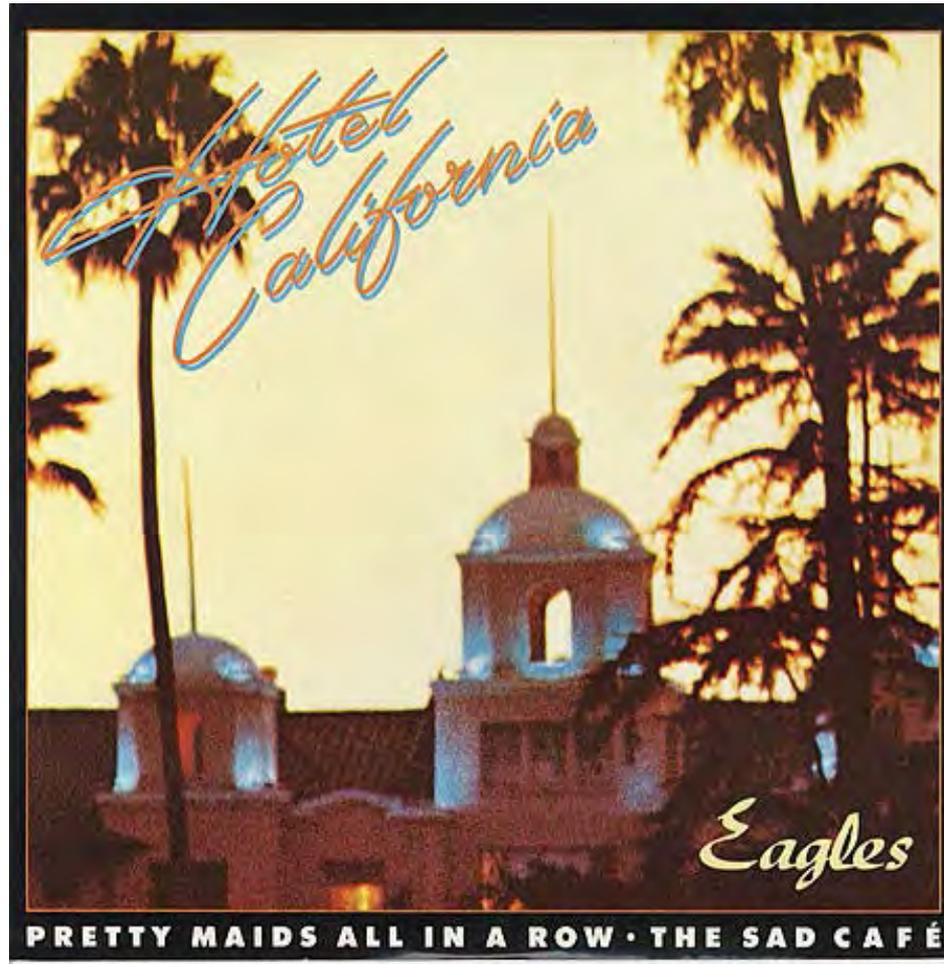
May 6, 2016

Michael Barnes, Dentons US LLP, San Francisco
Angela Elbert, Neal, Gerber & Eisenberg, LLP, Chicago

Overview -- Drowning In Privacy Rights. And Violations. And Regulations.

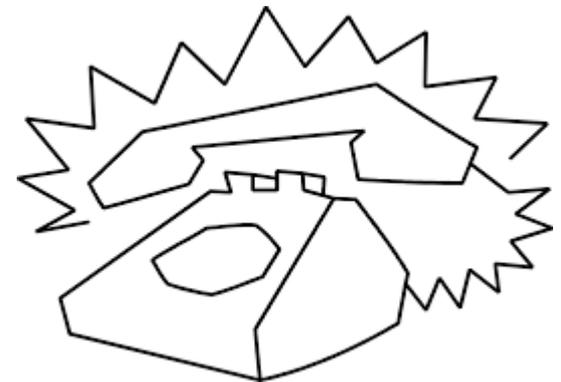


Regulation: If You're A Regulator, It's What You Do.



Regulations, New And Old. OK, Mostly New.

- Telephone Consumer Protection Act (TCPA)
- Controlling the Assault of Non-Solicited Pornography and Marketing Act (CAN-SPAM)
- Health Insurance Portability and Accountability Act (HIPAA)
- Fair Credit and Reporting Act (FCRA)
- Fair and Accurate Credit Transactions Act (FACTA)
- Mobile Online Relationship Organizations & Natural Infatuation Centers Act (MORONIC)
- Federal Wiretap Act
- Federal Stored Communications Act
- UCC section 9-625
- Song-Beverly Credit Card Act



Regulations, New And Old. OK, mostly New.

- Lanterman Petris Short Act* (California)
- Confidentiality of Medical Information Act (California)
- Preferred Provider Organization (Louisiana)
- Genetic Privacy Act (Alaska)



* 4,243 words. Not a "short" act.

The Perfect Storm: Statutory Damages, Class Actions, and Coverage Issues



A Concrete Example. It's what I'm talking about.

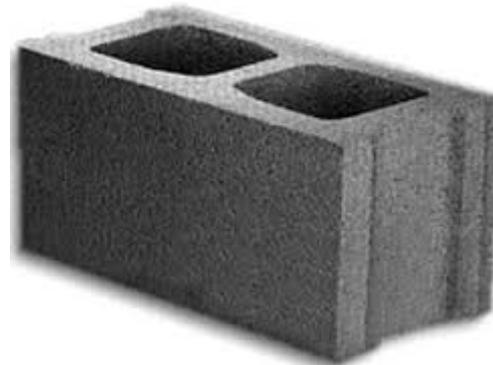
- California Confidentiality of Medical Information Act. (Cal. Civ. C. § 56.36(b)(1))*

[A]n individual may bring an action against a person or entity who has negligently released confidential information or records concerning him or her in violation of this part, for either or both of the following:

(1) . . . nominal damages of one thousand dollars (\$1,000). In order to recover under this paragraph, **it is not necessary that the plaintiff suffered or was threatened with actual damages.**

(2) The amount of actual damages, **if any**, sustained by the patient.

* 2,258 words.



More Concrete Examples.



- FACTA ("actual damages sustained by the consumer as a result of the failure or \$1,000, whichever is greater")
- CAN-SPAM ("the amount calculated by multiplying the number of violations . . . by up to \$250")
- HIPAA ("the amount determined under this paragraph is the amount calculated by multiplying the number of violations by up to \$100")
- Lanterman-Petris-Short ("In order to recover [\$1,000], it shall not be a prerequisite that the plaintiff suffer or be threatened with actual damages.")
- UCC (debtor "may recover . . . an amount not less than the credit service charge plus 10 percent of the principal amount of the obligation or the time-price differential plus 10 percent of the cash price")
- Song-Beverly Credit Card Act (imposing "civil penalty not to exceed two hundred fifty dollars (\$250) for the first violation and one thousand dollars (\$1,000) for each subsequent violation")

Part I: Are Statutory "Damages" Imposed "Because Of" A Covered Injury? (GL)

- Typical CGL insuring clause:

We will pay those sums that the insured becomes legally obligated to pay as damages because of "personal and advertising injury" to which this insurance applies.

- Are the sums "damages"?
- Are they imposed "because of . . . injury"?



Part I: Some Insurer Victories (Injury Required)

- *Whole Enchilada, Inc. v. Travelers Prop. Cas. Co. of America*, 581 F. Supp. 2d 677 (W.D. Pa. 2008) (FACTA)
- *ACE American Ins. Co. v. DISH Network LLC*, No. 1:13-cv-00560-REB-MEH, 2016 WL 1182743 (D. Colo., Mar. 28, 2016) (TCPA)
- *Ulta Salon, Cosmetics & Fragrance, Inc. v. Travelers Prop. Cas. Co. of America*, 197 Cal. App. 4th 424 (2011) (Prop 65)
- *Arch Ins. Co. v. Michaels Stores, Inc.*, No. 37-2011-00097053-CU-IC-CTL, 2013 WL 8752285 (Cal. Super. Ct. Dec. 20, 2013) (Song-Beverly)



Part I: Some Policyholder Victories (Violation-As-Injury)

- *Columbia Cas. Co. v. HIAR Holding, L.L.C.*, 411 S.W. 3d 258 (Mo. 2013) (TCPA)
- *Western Rim Investment Advisors, Inc. v. Gulf Ins. Co.*, 269 F. Supp. 2d 836 (N.D. Tex. 2003) (TCPA)
- *Standard Mut. Ins. Co. v. Lay*, 989 N.E. 2d 591 (Ill. 2013) (TCPA)
- *Hartford Cas. Ins. Co. v. Corcino & Associates*, No. CV 13–3728 GAF (JCx), 2013 WL 5687527 (C.D. Cal., Oct. 7, 2013) (medical privacy)



Part I: Are Statutory Damages "Loss"? (PL)

- Typical definition of "loss":

"Loss" means defense expenses and any monetary amount which an insured is legally obligated to pay as a result of a "claim." * * *

"Loss" shall not include . . . "fines, penalties, taxes, or punitive damages."

Note: coverage is for "wrongful acts," not injuries.

- Statutory damages are "monetary amounts" -- but are they "fines" or "penalties"?



Part I: Are There Two Buckets, Or Three?

- Damages vs. Penalties

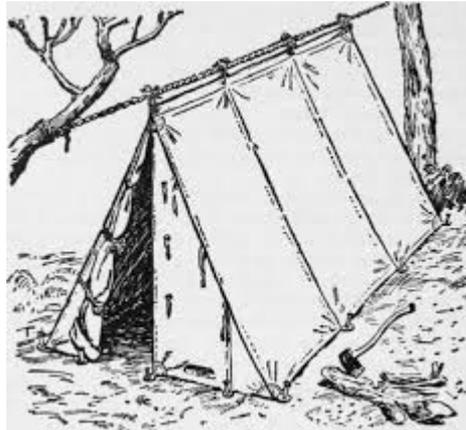


- Compensation vs. Penalties vs. Well, What Is It?



Part I: Insuring Clause -- Fines and Penalties Are Outside The Tent

- Typical language
 - CGL policy: insuring grant covers "damages"
 - PL policy: definition of "loss" "does not include:
 - Fines, penalties or taxes imposed by law; or
 - Matters which are uninsurable under the law of the jurisdiction governing this policy.



Part I: Insuring Clause -- Not Fines or Penalties



- *Western Rim Inv. Advisors, Inc. v. Gulf Ins. Co.*, 269 F. Supp. 2d 836 (N.D. Tex. 2003) (TCPA)
- *Columbia Cas. Co. v. HIAR Holding, L.L.C.*, 411 S.W. 3d 258 (Mo. 2013) (TCPA)
- *Flagship Credit Corp. v. Indian Harbor Ins. Co.*, 481 Fed. Appx. 907 (5th Cir. 2012) (UCC)
- *Evanston Ins. Co. v. Gene by Gene, Ltd.*, --- F.Supp.3d ---, 2016 WL 102294, *4 (S.D. Tex. Jan. 6, 2016) (Alaska Genetic Privacy Act)
- *Williams v. SIF Consultants of Louisiana, Inc.*, 133 So. 3d 707 (La. Ct. App. 2014) (PPO Discounts)
- *Navigators Ins. Co. v. Sterling Infosystems, Inc.*, 2015 NY Misc. LEXIS 2764 (Sup. Ct., July 28, 2015) (FCRA)

Part I: Insuring Clause -- Maybe Fines Or Penalties

- *Health Net, Inc. v. RLI Ins. Co.*, 206 Cal. App. 4th 232 (2012) (ERISA violations by fiduciary)
- *Wellcome v. Home Ins. Co.*, 849 P.2d 190, 193 (Mont. 1993) (litigation sanctions)



Part II(A): Exclusions (specific): "Recording And Distribution of Material Of Information In Violation of Law" (ISO CGL 2012)

- "Personal and advertising injury" arising directly or indirectly out of any action or omission that violates or is alleged to violate:
 - (1) *The Telephone Consumer Protection Act (TCPA), including any amendment of or addition to such law;*
 - (2) *The CAN-SPAM Act of 2003, including any amendment of or addition to such law;*
 - (3) *The Fair Credit Reporting Act (FCRA), and any amendment of or addition to such law, including the Fair and Accurate Credit Transactions Act (FACTA) or*
 - (4) *Any [other law] that addresses, prohibits, or limits the printing, dissemination, disposal, collecting, recording, sending, transmitting, communicating or distribution of material or information.*

Part II(A): Exclusions (specific)



- *MDC Acquisition Co. v. North River Ins. Co.*, 898 F. Supp. 2d 942 (N.D. Ohio 2012) (in TCPA case, court applies “Unsolicited Communications” exclusion for injury “arising out of unsolicited communications by or on behalf of any insured,” including violations of “the Telephone Consumer Protection Act and any amendments”)
- *Interline Brands, Inc. v. Chartis Specialty Ins. Co.*, 749 F.3d 962 (11th Cir. 2014) (in TCPA case, court applies exclusion for injury resulting from “any act that violates any statute, ordinance or regulation of any federal, state or local government . . . [that] applies to the sending, transmitting or communicating of any material or information, by any means whatsoever.”); *Emasco Ins. Co. v. CE Design, Ltd.*, 784 F.3d 1371 (10th Cir. 2015) (same).
- *Evanston Ins. Co. v. Gene by Gene, Ltd.*, --- F.Supp.3d ---, 2016 WL 102294 (S.D. Tex., Jan. 6, 2016) (genetic privacy violations held not similar to TCPA or CAN-SPAM violations)

Part II(A): Exclusions (specific) (statutory privacy)

- "Personal And Advertising Injury"

Arising out of the violation of a person's right to privacy created by any state or federal act.

However, this exclusion does not apply to liability for damages that the insured would have in absence of such state or federal act.



Part II(A): Exclusions (specific) (statutory privacy)

- *Big 5 Sporting Goods Corp. v. Zurich American Ins. Co.*, No. 13–56249, 2015 WL 8057228 (9th Cir., Dec. 7, 2015) (in "ZIP Code" suit under Song-Beverly Act, exclusion for violation of "Right Of Privacy Created By Statute," except "liability for damages that the insured would have in absence of" statute, applied because no common law right to ZIP Code privacy);
- *Hartford Cas. Ins. Co. v. Corcino & Assocs.*, No. CV 13–3728 GAF (JCx), 2013 WL 5687527 (C.D. Cal., Oct. 7, 2013) (same exclusion inapplicable to statutory medical privacy claims, as California Constitution recognized right of medical privacy)



Part II(B): The Last Resort – Public Policy.

- Argument: insuring "fines" or "penalties" undermines their deterrent purpose, hence violates public policy
- *Motorists Mut. Ins. Co. v. Dandy-Jim, Inc.*, 182 Ohio App. 3d 311 (2009) (TCPA); *Penzer v. Transportation Ins. Co.*, 545 F.3d 1303 (11th Cir. 2008); *Standard Mut. Ins. Co. v. Lay*, 989 N.E. 2d 591 (Ill. 2013); *Terra Nova Ins. Co. v. Fray-Witzer*, 869 N.E. 2d 565 (Mass. 2007) (all TCPA cases)
- *ACE American Ins. Co. v. DISH Network LLC*, No. 1:13-cv-00560-REB-MEH, 2016 WL 1182743 (D. Colo., Mar. 28, 2016)



Takeaways



- Check your "bucket list"
- Understand the statute
 - Is actual injury explicitly required? Explicitly not required?
 - Does it say "damages"? Fine? Penalty?
 - What other remedies are available? Punitives? Fines? Penalties?
 - What is the legislative intent?
- Understand the exclusion
 - Is it limited to privacy-type statutes?
 - What are the surrounding offenses?
 - What rights are **not** created by statute, at some level?

A Metaphor. (Or Is It A Simile?)



Humble Predictions





THE AMERICAN LAW INSTITUTE'S
RESTATEMENT OF THE LAW OF
LIABILITY INSURANCE

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History of The Restatement of the Law of Liability Insurance Project

- **May 2010, established as a Principles project:**
 - Reporters (T. Baker, U. Penn, and K. Logue, U. Mich.) prepare drafts
 - May 2013 & 2014: Chapters 1 and 2 approved in Principles format
- **October 2014, becomes a Restatement project:**
 - New Chapters 1 and 2 submitted (for discussion only) to 2015 ALI Annual Meeting
 - Chapters 1, 2, and 3 approved by Council and now slated for a vote at 2016 ALI Annual Meeting
 - May 2017: target completion date for entire project

Structure of the Restatement Project

Slated for May 2016 ALI Annual Meeting vote:

- Chapter 1: Basic Liability Insurance Contract Rules
- Chapter 2: Management of Potentially Insured Liability Claims
- Chapter 3: General Principles Regarding the Risks Insured

Still to come:

- Chapter 4: Advanced Contract Principles --Remedies

Hot Topics for Policyholders

- § § 2-4 – Interpretation
- §§ 7, 9 – Misrepresentation
- §§ 13, 18, 19 – Duty to Defend and Consequences of Breach
- § 42 – Exhaustion and Drop Down
- §§ 43 & 44 – Allocation

Note: Except as otherwise indicated, all references are to RESTATEMENT OF THE LAW OF LIABILITY INSURANCE, Tentative Draft No. 1 (April 11, 2016), scheduled for discussion and vote at the 2016 ALI Annual Meeting, May 16, 2016.

§ § 2-4 – Interpretation

- § 2 – Policy Interpretation Process
- § 3 – Presumption of Plain Meaning
- § 4 – Ambiguity / Use of Extrinsic Evidence

Interpretation Rules

§ 3. The Presumption in Favor of the Plain Meaning of Standard-Form Insurance Terms

(2) An insurance policy term is interpreted according to its plain meaning, if any, **unless extrinsic evidence shows that a reasonable person in the policyholder's position would give the term a different meaning.** That different meaning **must be more reasonable than the plain meaning in light of the extrinsic evidence**, and it must be a meaning to which the language of the term is reasonably susceptible.

§ 3, comment a:

* * * * *

This approach to extrinsic evidence **departs significantly from that of the most commonly articulated contextual approach**[, which] . . . requires the court to use available extrinsic evidence to determine whether the term is ambiguous. . . . The plain-meaning presumption stated in this Section also permits the use of extrinsic evidence, but the **objective is not to determine whether the term** has another reasonable interpretation and, hence **is ambiguous**, but rather to determine whether there is **another, more reasonable meaning.** In that process **the court gives the plain meaning greater weight than the latent meaning revealed through consideration of the extrinsic evidence.** ”

Interpretation Rules, cont.

§ 4. Ambiguous Terms

(1) An insurance policy term is ambiguous if there is **more than one meaning to which the language of the term is reasonably susceptible** when applied to the claim in question, without reference to extrinsic evidence regarding the meaning of the term.

(2) When an insurance policy term is ambiguous, **the term is interpreted in favor of the party that did not supply the term, unless the other party persuades the court that this interpretation is unreasonable in light of extrinsic evidence.**

(3) A standard-form insurance policy term is interpreted as if it were supplied by the insurer, without regard to which party actually supplied the term, unless the policyholder has agreed in writing to a contrary interpretive rule, in which case any term actually supplied by the policyholder will be interpreted using that contrary interpretive rule.

§§ 7, 9 – Misrepresentation

- “Innocent Misrepresentation”
- “Contribute to the Loss” Rule
- Rejection of Warranty Defenses

Misrepresentation Rules

§ 7. Misrepresentation

(2) . . . an insurer may deny a claim or rescind the applicable liability insurance policy on the basis of an incorrect representation made by a policyholder in an application for an insurance policy . . . only if the following requirements are met:

(a) The misrepresentation was material . . . ; and

(b) The insurer reasonably relied on the misrepresentation in issuing or renewing the policy. . . .

§ 8. Materiality Requirement

A misrepresentation by or on behalf of an insured during the application or renewal of an insurance policy is material only if, in the absence of the misrepresentation, a reasonable insurer in this insurer's position would not have issued the policy or would have issued the policy only under substantially different terms.

§ 9. Reasonable-Reliance Requirement

The reliance requirement of § 7(2)(b) is met only if,

(1) Absent the misrepresentation, the insurer would not have issued the policy or would have issued the policy only with different terms; and

(2) Such actions would have been reasonable under the circumstances.

Misrepresentation Rules – The Problem of Innocent Misrepresentations

Comment j:

A rule eliminating the rescission and claim denial remedies for innocent misrepresentations . . . has some precedent. Some jurisdictions have enacted statutes limiting misrepresentation to cases involving fraud or intent to deceive on the part of the policyholder. In addition, because of the harshness of the traditional rule, many jurisdictions have enacted cancellation statutes that have largely replaced misrepresentation doctrine in the context of automobile liability insurance. **This Section does not adopt a knowledge requirement, however, because there is not yet sufficient common-law authority to that effect despite the longstanding recognition of the unfairness of the strict-liability approach and the power of common-law courts to change common-law rules.**

Misrepresentation Rules – “Contribute-to-the-Loss”

§ 9, comment b: *The contribute-to-the-loss approach.* To demonstrate detrimental reliance it is sufficient that the insurer demonstrate that it would have charged a significantly higher premium had it received the correct information, even if that information had nothing to do with the risk that produced the loss in question. **It is sometimes suggested that insurance law should limit the insurer’s misrepresentation defense to situations in which the misrepresentation by the policyholder actually materialized in (“contributed to”) the loss that occurred and for which the insured filed a claim.** This is often referred to as the “contribute-to-the-loss” or “causal relation” approach. The proponents of this approach argue that requiring such a close causal connection between the policyholder’s misrepresentation and the actual loss suffered by the insured protects insureds from arbitrary outcomes. . . .

This Section does not follow the contribute-to-the-loss approach

§§ 13, 18, 19 – Duty to Defend

- § 13– Standard
 - Role of Extrinsic Evidence
 - “One-Way Rule”
- § 18 – Termination of the Duty to Defend
- § 19 – Consequences of Breach

Duty to Defend – “Four Corners Plus”

§ 13. Conditions Under Which the Insurer Must Defend

- (2) For the purpose of determining whether an insurer must defend, the legal action is deemed to be based on:
 - (a) Any allegation contained in the complaint . . . ; and
 - (b) **Any additional allegation . . . that a reasonable insurer would regard as an actual or potential basis for all or part of the legal action.**

Comment b. *The potential for coverage.* If the insurer knows or reasonably should know of information that . . . could reasonably be expected to be added as an allegation, and that, if so added, would require the insurer to defend, then the insurer has a duty to defend the action. **Except as provided in subsection (3), the consideration of facts outside the complaint works in one direction only:** [unalleged] facts or circumstances . . . generally may not be used to justify a refusal or failure to defend. **Such information may be used, however, in a declaratory-judgment action brought by the insurer seeking to terminate its duty to defend an action that it is defending under a reservation of rights.**

Duty to Defend, cont.

§ 13. Conditions Under Which the Insurer Must Defend

(As revised since last Annual Meeting of the ALI)

(3) Unless **undisputed facts that are not at issue or potentially at issue in the legal action for which a defense is sought** establish as a matter of law that the legal action is not covered, the insurer must defend until its duty to defend is terminated under § 18.

~~(3) For the purpose of determining whether an insurer must defend, the following coverage questions are determined based on all of the facts and circumstances reasonably available to the insurer at the time the determination is made:~~

- ~~(a) **Whether a person or entity is insured** under a liability insurance policy; and~~
- ~~(b) **Whether a vehicle at issue in a claim is a vehicle for which insurance coverage is available** under an automobile or similar liability insurance policy.~~

Duty to Defend, cont.

§ 18. Terminating the Duty to Defend a Claim

An insurer's duty to defend a legal action terminates only upon the occurrence of one or more of the following events:

* * * * *

(7) A correct determination by the insurer based on undisputed facts not at issue or potentially at issue in the legal action for which the defense is sought, as permitted under § 13(3); or

(8) Final adjudication that the insurer does not have a duty to defend the action.

Comment j. Adjudication that there is no duty to defend. An insurer that is providing a defense . . . may avoid the continued duty to defend through a [DJ] seeking to prove that the action is not covered, **subject to any applicable rules of the jurisdiction regarding the scope and timing of [DJ] actions.** . . . In the [DJ], the insurer's continuing duty to defend is **adjudicated on the basis of all the relevant facts and circumstances**, without a presumption that the facts set forth in the complaint or comparable document that concern coverage are true. For example, **the insurer may prove that the action is excluded because the insured's conduct falls within the scope of an exclusion in the policy.** . . .

Consequences of Breach of Duty to Defend

(As revised since May 2015, last Annual Meeting of the ALI)

§ 19. Consequences of Breach of the Duty to Defend

- (1) An insurer that breaches the duty to defend a legal action loses the right to assert any control over the defense or settlement of the action [~~*deleted from prior draft: and the right to contest coverage for the claim*~~].
- (2) An insurer that breaches the duty to defend **without a reasonable basis for its conduct** must provide coverage for the legal action for which the defense was sought, notwithstanding any grounds for contesting coverage that the insurer could have preserved by providing a proper defense under a reservation of rights pursuant to § 15.

Consequences of Breach of Duty to Defend, cont.

§ 19, Comment a. *The importance of defense coverage.* The rules in this Section identify additional consequences, beyond ordinary contract damages, for breach of the duty to defend. **These rules reflect the importance of the defense coverage provided by traditional liability insurance policies,** which promise to pay for the defense of any potentially covered claim and, in most cases, also to select the defense lawyer and manage the defense. Liability insurance defense coverage provides the access to civil justice for defendants that corresponds to the access to civil justice that contingent-fee arrangements make possible for plaintiffs. **Without an insurer-funded defense lawyer, many if not most consumers and small businesses would be deprived of an adequate defense. . . .**

Consequences of Breach of Duty to Defend, cont.

§ 19, Comment b. Providing an incentive to fulfill the duty to defend. The rule in subsection (2) encourages insurers to fulfill their duty to defend by providing a consequence for a wrongful breach of that duty that corrects the misalignment of incentives that might otherwise lead a rational insurer to abandon its insured in some cases. Ordinary contract damages may not provide an adequate incentive for insurers to defend in cases in which the insurer believes that the coverage-relevant facts ultimately will be resolved in its favor, notwithstanding the insurer's clear duty to defend. Thus, **the rule in subsection (2) is a corollary to the complaint-allegation rule, which requires insurers to resolve all factual uncertainty in favor of coverage when deciding whether to defend.** . . . An insurer that could abandon the defense whenever it concludes that the coverage relevant facts are in its favor, without significant risk of having to pay a judgment or settlement of the action, would have an incentive to do so. That **incentive would be especially strong if the insured did not have the resources to pay for an effective defense.** . . . **The rule in subsection (2) changes that calculus** by exposing the insurer to the risk of having to pay the full claim, thereby encouraging the insurer to fulfill its duty.

Consequences of Breach of Duty to Defend, cont.

§ 19, Comment c. Precedent for subsection (2). The rule in subsection (2) is a **middle ground** between the rule in some jurisdictions that an insurer that breaches the duty to defend loses the right to contest coverage even if it had a reasonable basis for its conduct and the rule in other jurisdictions that the insurer that breaches the duty to defend retains the ability to contest coverage. . . . **The objective, no-reasonable-basis standard in subsection (2) is one of the leading standards for what constitutes a bad-faith breach. . . .** Specifying this standard and remedy in this important context, without using the term “bad faith breach,” **leaves room for courts to adopt a different standard for bad-faith breach** in other contexts or for other remedies. Courts in a respectable minority of states have held that any time that an insurer refuses to defend a suit in violation of its duty to defend, the insurer must pay for a judgment entered in, or a reasonable settlement of, the suit, even if the insurer had a reasonable basis for declining to defend. The cases adopting this broad “forfeiture-of-coverage-defenses” rule provide support for the narrower rule in subsection (2), pursuant to which the insurer loses the right to contest coverage only if the insured demonstrates that the insurer lacked a reasonable basis for its conduct.

Consequences of Breach of Duty to Defend, cont.

(Superseded rule for legal uncertainty from Discussion Draft presented at last Annual Meeting of the ALI)

§ 13, Comment f. Legal uncertainty. In some cases, coverage for a claim may be uncertain because of legal uncertainty. For example, the courts of the relevant jurisdiction may not have yet determined the meaning of an insurance policy term or there may be uncertainty regarding the application of the policy term to the facts as alleged in the complaint. . . . **An insurer facing such legal uncertainty has two options. First, the insurer may deny the claim. . . . If the insurer's legal position is correct, the insurer will not have breached the duty to defend and it will have avoided incurring the costs of defense. If the insurer's legal position turns out to be incorrect, it will have breached the duty to defend, with the consequences stated in § 19. Second, the insurer may defend the claim while reserving the right to contest coverage under § 15, in which case it retains control over the claim. If the insurer defends the claim under a reservation of rights, the adjudication of the insurer's obligation to indemnify the insured for a judgment will be based on all of the facts and circumstances**

§§ 43 & 44 – Allocation

- “All-Sums” as “General Rule” – “Concurrent” Policies
- “Straight Prorata” Exception Rule for Long-Tail Claims Triggering “Successive” Policies
- Motion to “Recommit”

Allocation: Original Unified Rule

(Principles Project as presented at 2014 Annual Meeting of the ALI and Meetings of Advisers and Members Group)

§ 40. The Joint and Several Liability Default Allocation Rule

Except as provided in § 41, when multiple liability insurance policies are triggered with respect to a single claim, **the settlement and indemnification obligations under those policies are jointly and severally owed to the insured,** notwithstanding any term in any insurance policy that seeks to establish a different formula or priority for allocating the liability among such insurers.

Principles of the Law, Liability Insurance, Preliminary Draft No. 6 (Mar. 10, 2014), at 34/2-7 (emphasis added).

Allocation: the “General Rule”

§ 43. Indemnification from Multiple Policies: The General Rule

(1) When more than one insurance policy provides coverage to an insured for a legal action, **the insurers are jointly and severally liable to the insured under their policies**, subject to the limits of each policy, **except** as otherwise provided in subsection (2) or § 44.

(2) When an insurance policy contains a term that alters the default rule stated in subsection (1), that term will be given effect, except to the extent that the term cannot be harmonized with an allocation term in another policy and provided that there is no more allocation to the insured than there would have been under the applicable policy that is most favorable to the insured with regard to allocation.

(3) When multiple insurers have a duty to defend an insured for a claim, the insurers’ defense obligations are governed by § 20.

Allocation: Exception for Long-Tail Claims

§ 44. Allocation in Long-Tail Harm Claims Covered by Occurrence-Based Policies

(1) Except as stated in subsection (2), when indivisible harm occurs over multiple years, the amount of any judgment . . . or settlement . . . arising out of that harm is subject to **pro rata allocation** as follows:

(a) . . . the amount of the judgment or settlement is **allocated equally across years**, beginning with the first year in which the harm occurred and ending with the last year in which the harm would trigger an occurrence-based liability insurance policy; and

(b) An insurer's obligation to pay for that pro rata share is subject to the ordinary rules governing any deductible, self-insured retention, policy limit, or exhaustion terms in the policy.

(2) When an insurance policy contains a term that alters the default rule stated in subsection (1), that term will be given effect, except to the extent that the term cannot be harmonized with an allocation term in another policy that provides coverage for the claim.

(3) Defense obligations relating to multiple triggered policies are subject to the rules in § 20.

Allocation: the Pre-1986 CGL Policy Language

I. COVERAGE A — BODILY INJURY LIABILITY

COVERAGE B — PROPERTY DAMAGE LIABILITY

The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of

A. bodily injury or

B. property damage

to which this insurance applies, caused by an occurrence, ...

* * * * *

“bodily injury” means bodily injury, sickness or disease sustained by any person which occurs during the policy period, including death at any time resulting therefrom;

....

“property damage” means (1) physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, ...

Exhaustion and Drop Down

§ 42. Excess Insurance: Exhaustion and Drop Down

(2) The underlying policy is exhausted when an amount equal to the limit of that policy has been paid to claimants for a covered loss, or for other covered benefits whose payment is subject to that limit, by or on behalf of either the underlying insurer or the insured.

Comment d: The most serious objection that excess insurers have expressed with respect to the *Zeig* rule is based upon the belief that only a payment-by-insurers requirement guarantees that the underlying claim will be fully vetted. On this view, insureds themselves are typically not as experienced or skilled at evaluating, settling, or litigating lawsuits as primary insurance companies are, and insureds may have reasons for settling that take into account consequences other than the potential for an adverse judgment.

Hot Topics for Insurance Companies

- § § 3-4 – Interpretation
- §12: Liability of Insurer for Conduct of Defense
- §19 Consequences of Breach of Duty to Defend
- § 34 Coverage for Aggravated Fault
- § 37 Notice of Claim Conditions
- § 31 Assignment of Rights under Policies
- §41 Number of “Occurrences”

§ 3. The Presumption in Favor of the Plain Meaning of Standard-Form Insurance Policy Terms

- (1) The plain meaning of an insurance policy term is the single meaning, if any, to which the language of the term is reasonably susceptible when applied to the claim at issue, in the context of the insurance policy as a whole, without reference to extrinsic evidence regarding the meaning of the term.**
- (2) An insurance policy term is interpreted according to its plain meaning, if any, unless extrinsic evidence shows that a reasonable person in the policyholder's position would give the term a different meaning. That different meaning must be more reasonable than the plain meaning in light of the extrinsic evidence, and it must be a meaning to which the language of the term is reasonably susceptible.**

§ 12. Liability of Insurer for Conduct of Defense

- **An insurer exercising the right to defend a legal action is subject to liability for the negligence of defense counsel and related service providers in relation to the action if:**
 - 1. Defense counsel is an employee of the insurer acting within the scope of employment; or
 - 2. The insurer negligently selects or supervises defense counsel, including by retaining counsel with inadequate liability insurance.

§ 19. Consequences of Breach of the Duty to Defend

(1) An insurer that breaches the duty to defend a legal action loses the right to assert any control over the defense or settlement of the action.

(2) An insurer that breaches the duty to defend without a reasonable basis for its conduct must provide coverage for the legal action for which the defense was sought, notwithstanding any grounds for contesting coverage that the insurer could have preserved by providing a proper defense under a reservation of rights pursuant to § 15.

§ 34. Insurance of Liabilities Involving Aggravated Fault

(1) A liability insurance policy may cover defense costs incurred in connection with any legal action, including but not limited to: a criminal prosecution; an action seeking fines, penalties, or punitive damages; and an action alleging criminal acts, intentionally caused harm, fraud, or other conduct involving aggravated fault.

(2) A liability insurer may pay damages to a third-party claimant for the civil liability of the insured for criminal acts, intentionally caused harm, fraud, or other conduct involving aggravated fault. If insulating the insured from the financial consequences of such liability would contravene the public purpose of the imposition of liability, the insurer may seek indemnification from the insured for any amounts the insurer paid to or on behalf of the claimant.

§ 37. Notice-of-Claim Conditions

(1) The failure of the insured to satisfy a notice-of-claim condition excuses an insurer from performance of its obligations under a liability insurance policy only if the insurer demonstrates that it was prejudiced as a result, except as stated in subsection (2).

(2) The rule stated in subsection (1) does not apply when a claim is first reported to the insurer after the end of the reporting period of a claims-made-and-reported policy, provided that the insured was afforded a reasonable time in which to report the claim.

§ 38. Assignment of Rights Under Liability Insurance

- (1) Except as otherwise stated in this Section, rights under a liability insurance policy are subject to the ordinary rules regarding the assignment of rights under a contract.**
- (2) Rights of an insured under an insurance policy relating to a specific claim that has been made against the insured may be assigned without regard to an anti-assignment condition or other term in the policy restricting such assignments.**
- (3) Rights of an insured under an insurance policy relating to a class of claims or potential claims may be assigned without regard to an anti-assignment condition or other term in the policy restricting such assignments, provided the following requirements are met:**
 - (a) The assignment accompanies the transfer of financial responsibility for the underlying liabilities insured under the policy as part of a sale of corporate assets or similar transaction;**
 - (b) The assignment takes place after the end of the policy period; and**
 - (c) The assignment of the rights does not materially increase the risk borne by the insurer.**

§ 41. Number of Accidents or Occurrences

- **For liability insurance policies that have per-accident or per-occurrence policy limits, retentions, or deductibles, the number of accidents or occurrences is determined by reference to the cause(s) of the bodily injury, property damage, or other harm that forms the basis for the claim, unless otherwise stated in the policy.**

LOOKING FORWARD

- Chapters 1, 2 and 3:
 - Will be presented at ALI Annual Meeting on May 16, 2016
 - Floor debate?
- Chapter 4
 - Bad Faith; Liability of Agents and Brokers; Remedies
 - Reporters will submit this Fall
 - Vote at ALI Annual Meeting in May 2017

QUESTIONS?

