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Insurance Law Alert

April 2015

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Third Circuit Rules That "Insured Property" Does Not Encompass Land

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Florida Appellate Court Rules That Post-Loss Assignee of Insurance Rights Not Required to Have an Insurable Interest in the Property at the Time of Loss

A Florida appellate court ruled that state statutory law requiring an insurable interest in property at the time of loss does not apply when the original insured assigns insurance policy rights to another party after a loss has occurred. *Accident Cleaners, Inc. v. Universal Ins. Co.*, 2015 WL 1609973 (Fla. Dist. Ct. App. Apr. 10, 2015). (click here for full article)

Wisconsin Court Rules That Insurers Are Equitably Estopped From Choosing Policyholder Counsel

A Wisconsin federal district court ruled that insurers were estopped from requiring a policyholder to accept the insurers' choice of counsel because of the insurers' delay in selecting counsel. *Haley v. Kolbe & Kolbe Millwork Co., Inc.*, 2015 WL 1505686 (W.D. Wis. Apr. 1, 2015). (click here for full article)

Strictly Enforcing Notice Requirements, Kentucky Court Rejects "Seamless Coverage" Argument for Consecutive Claims-Made Policies

A Kentucky federal district court ruled that a policyholder forfeits coverage by violating an unambiguous notice provision in a claims-made policy regardless of whether notice is subsequently provided under a consecutive policy. *C.A. Jones Mgmt. Grp., LLC v. Scottsdale Indem. Co.*, 2015 WL 1393261 (W.D. Ky. Mar. 25, 2015). (click here for full article)

Fifth Circuit Finds That Arbitrator Exceeded His Authority and Vacates Arbitration Award

The Fifth Circuit ruled that when an arbitrator is appointed in a manner inconsistent with the procedures set forth in the agreement to arbitrate, the award must be vacated. *PoolRe Ins. Corp. v. Organizational Strategies, Inc.*, 2015 WL 1566633 (5th Cir. Apr. 7, 2015). (click here for full article)

New York Appellate Court Finds Questions of Fact as to Existence and Scope of "Follow the Settlements" Clause

A New York appellate court ruled that questions of fact exist as to whether a reinsurance certificate provision constituted a "follow the settlements" clause, and if it did, whether it precluded a reinsurer from challenging the allocation of underlying settlement proceeds. *New Hampshire Ins. Co. v. Clearwater Ins. Co.*, 2015 WL 1292579 (N.Y. App. Div. Mar. 24, 2015). (click here for full article)

Reinsurer Need Not Establish Prejudice for Late Notice Defense Under Illinois Law, Says Second Circuit

Applying Illinois law, the Second Circuit ruled that a reinsurer was entitled to deny coverage based on late notice, regardless of prejudice. *Granite State Ins. Co. v. Clearwater Ins. Co.*, 2015 WL 1474605 (2d Cir. Apr. 2, 2015). (click here for full article)

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The Vermont Supreme Court ruled that an absolute pollution exclusion bars coverage for injuries caused by spray foam insulation fumes, rejecting the trial court's holding that the exclusion is limited to traditional environmental hazards. *Cincinnati Specialty Underwriters Ins. Co. v. Energy Wise Homes, Inc.*, 2015 WL 1524206 (Vt. Apr. 3, 2015).
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Georgia Supreme Court Rules That Bad Faith Claim Is Precluded Where Policyholder Settled Without Insurer Consent

The Georgia Supreme Court ruled that a policyholder that violates a "consent to settle" clause is precluded from asserting bad faith refusal to settle against its insurer. *Piedmont Office Realty Trust, Inc. v. XL Specialty Ins. Co.*, 2015 WL 1773620 (Ga. Apr. 20, 2015).
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Sixth Circuit Rules That Federal Taxing Statute Allows Prevailing Party to Shift the Costs of Imaging a Computer's Hard Drive

The Sixth Circuit clarified that federal statutory law permitting a prevailing party to recover reasonable and necessary litigation expenses allows recovery of the costs of imaging a computer hard drive or other physical storage device. *Colosi v. Jones Lang LaSalle Americas, Inc.*, 781 F.3d 293 (6th Cir. 2015). (click here for full article)

Property Insurance Alerts:

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The coverage dispute arose out of construction defect claims. The homeowners (as assignees of the builder's rights to insurance proceeds) sued Mid-Continent, seeking coverage under four consecutive liability policies issued between 2005 and 2008. Mid-Continent argued that it had no duty to defend because the underlying complaint alleged that the defects could not have been discovered until 2010, after the expiration of the last policy period. A Florida federal district court disagreed, ruling that the determination of whether property damage occurred during any Mid-Continent policy period was based on "the date of the actual damage" rather than the date of manifestation or discovery of damage. The district court found that actual damage caused by wood rot occurred in 2005 and thus that the 2005-2006 policy was triggered. The Eleventh Circuit affirmed.

The Eleventh Circuit ruled that Mid-Continent had a duty to defend the underlying suit in light of the uncertainty as to Florida trigger law in this context. Noting that Florida law is unclear as to which trigger applies to insurance claims for property damage, the Eleventh Circuit found that "Mid-Continent did not know whether there would be coverage for the damages sought in the underlying action because Florida courts had not decided which trigger applies. Mid-Continent was required to resolve this uncertainty in favor of the insured and offer a defense to [the builder]." Turning to the issue of indemnity, the court held that based on the factual record presented, the district court properly applied an injury-in-fact trigger. The court reasoned that property damage occurs "when the damage happens, not when the damage is discovered or discoverable." Significantly, the court declined to establish a bright line rule and expressly limited its holding to the facts presented—namely, a situation in which the date of actual damage was discernable. The court cautioned that it had "no opinion on what the trigger should be where it is difficult (or impossible) to determine when the property was damaged."

Third Circuit Rules That "Insured Property" Does Not Encompass Land

In the wake of Storm Sandy and other recent storms, disputes over the scope of first-party coverage have proliferated. In a recent decision, the Third Circuit addressed the unsettled question of whether the term "insured property" in a flood insurance policy encompasses the parcel of land on which a home is built. The court held that a standard flood policy does not cover the expenses of removing debris from the land surrounding an insured house. *Torre v. Liberty Mut. Fire Ins. Co.*, 781 F.3d 651 (3d Cir. 2015).

The standard flood policy at issue provided coverage for the expense of removing debris "that is on or in insured property." The homeowners argued that the undefined term "insured property" should be read to encompass the entire parcel of land. The insurer contended that it should be read to apply only to the specific structures and items of property listed in the policy. Agreeing with the insurer, the court held that "insured property" unambiguously referred only to the structure or other items

specified in the policy. In so ruling, the court deemed it insignificant that the address of the land parcel was listed on the policy's declarations page, emphasizing that the policy distinguished between the "described location" (*i.e.*, the address) and the "insured property" (*i.e.*, the structure).

Florida Appellate Court Rules That Post-Loss Assignee of Insurance Rights Not Required to Have an Insurable Interest in the Property at the Time of Loss

A Florida appellate court ruled that state statutory law requiring an insurable interest in property at the time of the loss does not apply when the original insured assigns insurance policy rights to another party after a loss has occurred. *Accident Cleaners, Inc. v. Universal Ins. Co.*, 2015 WL 1609973 (Fla. Dist. Ct. App. Apr. 10, 2015).

A homeowner assigned the rights to his property policy to a cleaning service company after a loss. When the insurance company refused to pay the full amount of cleaning services associated with the loss, the cleaning company filed suit. The trial court dismissed the complaint on the basis that the cleaning company did not have an insurable interest in the property at the time of loss, as required by Florida statutory law. *See* Florida Statutes section 627.405 ("No contract of insurance of property … shall be enforceable … except for the benefit of persons having an insurable interest in the things insured as at the time of the loss"). The appellate court reversed.

The appellate court ruled that section 627.405 does not require a post-loss assignee to have an insurable interest at the time of loss. The court reasoned that under Florida common law, the right to recover under an insurance contract is freely assignable after loss. The court explained that because section 627.405 did not express an intent to displace or otherwise alter this common law, an owner's insurable interest may be imputed to a post-loss assignee so long as the property owner who holds the insurance policy had an insurable interest at the time of the loss. As the court noted, "[t]his interpretation allows both the insurable-interest requirement and free assignability of post-loss claims to coexist."

Defense Alert:

Wisconsin Court Rules That Insurers Are Equitably Estopped From Choosing Policyholder Counsel

A Wisconsin federal district court ruled that insurers were estopped from requiring a policyholder to accept the insurers' choice of counsel because of the insurers' delay in selecting counsel. *Haley v. Kolbe & Kolbe Millwork Co., Inc.*, 2015 WL 1505686 (W.D. Wis. Apr. 1, 2015).

Policyholder Kolbe Millwork tendered defense of a product liability suit to its insurers in February 2014. That same month, Kolbe notified its insurers of its choice of counsel. The insurers acknowledged their defense obligation and did not object to Kolbe's counsel selection, but noted their consideration of other potential defense firms. In June 2014, the insurers provided Kolbe with a choice of two law firms to serve as defense counsel. By that time, Kolbe's original counsel had answered the underlying complaint, prepared initial disclosures, filed preliminary motions, issued and prepared responses to discovery requests and retained experts. As a result, Kolbe refused to consider the insurers' counsel choices. Thereafter, the insurers filed a motion to intervene in the underlying action and sought a declaration that they had the right to choose defense counsel. The court disagreed.

In deciding whether the insurers had the right to select counsel, the court assumed, without deciding, that the insurers did not forfeit their right to control the defense (including the selection of counsel) by issuing a reservation of rights. However, the court concluded that the insurers were equitably estopped from enforcing the insurers' choice of counsel by their inaction over the course of four months. The court explained that estoppel applied because Kolbe reasonably relied on the insurers' inaction as to choice of counsel and would be prejudiced by a change of counsel after its own attorneys had "already invested significant time and resources into the case." The court also pointed to the insurers' delay in seeking relief from the court as a basis for its estoppel ruling.

Notice Alert:

Strictly Enforcing Notice Requirements, Kentucky Court Rejects "Seamless Coverage" Argument for Consecutive Claims-Made Policies

Our November 2010 Alert reported on a controversial Kentucky appellate court decision holding that a policyholder's failure to report a claim during the period of a claims-made policy did not bar coverage for the claim. *AIG Domestic Claims, Inc. v. Tussey*, 2010 WL 3603844 (Ky. Ct. App. Sept. 17, 2010). There, although the policyholder failed to report a claim within the policy period in which it arose (and instead reported it in a subsequent policy period), the court allowed coverage, reasoning that the two policies created "seamless coverage over the two-year period." As the *Tussey* dissent

observed, the majority's decision "break[s] rank with the overwhelming majority of jurisdictions all over this country who have repeatedly held that failure to notify an insurer within the policy period in a claims-based policy defeats coverage under the policy." In a decision issued last month, a Kentucky federal district court expressly rejected *Tussey* and ruled that a policyholder forfeits coverage by violating an unambiguous notice provision in a claims-made policy regardless of whether notice is subsequently provided under a consecutive policy. *C.A. Jones Mgmt. Grp., LLC v. Scottsdale Indem. Co.*, 2015 WL 1393261 (W.D. Ky. Mar. 25, 2015).

In *Jones Management*, the court discounted *Tussey*'s persuasive value, stating that it is undermined by basic principles of contract interpretation which require courts to afford an insurance policy its plain meaning. The unambiguous policy language at issue "requires that even if an insured purchases consecutive claims-made policies with the same insurer, he must nonetheless satisfy the reporting requirements provided in the policy." The court also criticized *Tussey* as improperly creating a "long and unbargained-for tail of liability exposure" under claims-made policies. In recent months, several other courts have also rejected the "seamless coverage" approach set forth in *Tussey* and held that claims-made reporting requirements must be strictly applied as written. *See* February 2015 Alert.

Arbitration Alert:

Fifth Circuit Finds That Arbitrator Exceeded His Authority and Vacates Arbitration Award

Because courts use a highly deferential standard in reviewing arbitration awards, petitioners face an uphill battle when they file motions to vacate arbitration awards. However, in a recent decision, the Fifth Circuit ruled that when an arbitrator is appointed in a manner inconsistent with the procedures set forth in the agreement to arbitrate, the award must be vacated. *PoolRe Ins. Corp. v. Organizational Strategies, Inc.*, 2015 WL 1566633 (5th Cir. Apr. 7, 2015).

The dispute at issue involved two separate but related sets of arbitration agreements: (1) service agreements between Capstone and Organizational Strategies, Inc. ("OSI"), which required AAA arbitration; and (2) reinsurance agreements between PoolRe and certain captive insurance companies, which required ICC arbitration. When billing disputes arose between Capstone and OSI, PoolRe cancelled its reinsurance agreements with the captives. Thereafter, Capstone initiated arbitration against OSI. The arbitration demand was forwarded to Dion Ramos of Conflict Resolution Systems in Texas, who appointed himself arbitrator in the Capstone-OSI arbitration (governed by the AAA). PoolRe intervened in the arbitration for the

limited purpose of having Ramos appoint an Anguilla-based arbitrator, as required by the PoolRe arbitration agreements. Ramos, applying AAA guidelines, ruled that PoolRe waived its right to arbitration in Anguilla by intervening and that he had jurisdiction to decide PoolRe's claims. After Ramos issued an arbitration award, the parties filed competing motions in Texas federal district court to confirm and vacate the award and to compel a second phase arbitration. The court found that Ramos was not selected in the manner required by the PoolRe agreement and that he exceeded his authority by exercising jurisdiction over and applying AAA rules to the dispute between PoolRe and the captives. The court vacated the award and the Fifth Circuit affirmed.

The Fifth Circuit ruled that vacatur of the award was justified because the selection of Ramos as arbitrator did not conform with the selection process of the PoolRe-captive reinsurance agreements. The court explained that arbitrator selection is a material contract term and that a non-trivial departure from authorized procedures warrants vacatur. The court further reasoned that Ramos exceeded his authority by applying AAA rather than ICC rules to the dispute in contravention of the PoolRe arbitration clause. The court held that by violating this provision, Ramos exceeded his authority. Finally, the Fifth Circuit held that vacatur of the entire award was appropriate and that the district court was not obligated to "carve out only the objectionable part of the award [relating to PoolRe] and confirm the rest." Although district courts have the discretion to partially vacate an award, they are not required to do so, particularly where, as here, the entire arbitration process was tainted and the award is not easily divisible.

Reinsurance Alerts:

New York Appellate Court Finds Questions of Fact as to Existence and Scope of "Follow the Settlements" Clause

A New York appellate court ruled that questions of fact exist as to whether a reinsurance certificate provision constituted a "follow the settlements" clause, and if it did, whether it precluded a reinsurer from challenging the allocation of underlying settlement proceeds. *New Hampshire Ins. Co. v. Clearwater Ins. Co.*, 2015 WL 1292579 (N.Y. App. Div. Mar. 24, 2015).

New Hampshire Insurance Company and several other AIG-affiliated insurers settled hundreds of millions of dollars of asbestos claims with Kaiser Aluminum. The settlement gave AIG the right to allocate the settlement amount at their sole discretion. AIG allocated 100% of the settlement to claims within the coverage of a New Hampshire excess policy reinsured by Clearwater. When Clearwater challenged the reasonableness of the allocation, New Hampshire argued that language in the reinsurance certificates stating that Clearwater's "liability … shall follow [New Hampshire's] liability in accordance with the terms and conditions of the policy reinsured hereunder" established a "follow the fortunes" requirement and that Clearwater was bound by AIG's settlement allocation. A New York trial court ruled that (1) Clearwater was collaterally estopped from denying that the certificates imposed a duty to "follow the settlements" in light of a Massachusetts trial court decision interpreting similar language; and (2) notwithstanding the deference afforded to a ceding insurer's coverage decisions pursuant to a "follow the settlements" clause, there were questions of fact as to the reasonableness of the allocation and whether Clearwater should be bound by it. The appellate court affirmed in part and reversed in part.

Reversing the collateral estoppel ruling, the appellate court held that Clearwater was not bound by a different state court's construction of the relevant language because the dispute before the court concerned "a different certificate issued to a different cedent with respect to an underlying policy covering a different insured." The court further found that the language at issue constituted a "following form" requirement (for the purpose of achieving concurrency between the reinsured contract and the reinsurance policy), not a "follow the settlements" provision. The court then considered whether a "follow the settlements" duty is implied in reinsurance contracts even in the absence of a contractual provision. Noting conflicting decisions in this context, the court declined to resolve the question and instead held that even assuming that Clearwater was obligated to follow the settlements, there were questions of fact as to the reasonableness of AIG's settlement allocation. In particular, the court noted that the allocation decision was made unilaterally by AIG and that none of the settlement payments were allocated to certain categories of claims, such as premises claims or defense costs. Because the record did not establish "whether or not it was reasonable to allocate no portion of the settlement to claims that were not asserted against New Hampshire or were not even covered by its policy," summary judgment was unwarranted. The appellate court also reversed the trial court's summary judgment ruling on late notice, finding that Clearwater had raised triable issues of fact as to whether New Hampshire complied with the contractual notice provisions and as to whether any delay resulted in prejudice.

Reinsurer Need Not Establish Prejudice for Late Notice Defense Under Illinois Law, Says Second Circuit

Our September 2014 Alert reported on a Second Circuit decision holding that under Illinois law, late notice defeats a ceding insurer's coverage claim regardless of prejudice to the reinsurer. *AIU Ins. Co. v. TIG Ins. Co.*, 2014 WL 4211080 (2d Cir. Aug. 27, 2014). There, the Second Circuit explicitly ruled that Illinois law does not require a showing of prejudice. The decision is noteworthy because neither the Illinois Supreme Court nor any Illinois appellate courts have directly addressed this issue. In a decision issued this month, the Second Circuit again ruled that Illinois law permits a reinsurer to deny coverage based on late notice, regardless of prejudice. *Granite State Ins. Co. v. Clearwater Ins. Co.*, 2015 WL 1474605 (2d Cir. Apr. 2, 2015). Citing to *AIU*, the court noted that the consensus drawn from various state and federal decisions interpreting Illinois reinsurance law was that Illinois has endorsed a no prejudice rule.

Pollution Exclusion Alert:

Vermont Supreme Court Rules That Pollution Exclusion Is Not Limited to Traditional Environmental Contamination

Reversing a trial court decision, the Vermont Supreme Court ruled that an absolute pollution exclusion bars coverage for injuries caused by spray foam insulation fumes, rejecting the trial court's holding that the exclusion is limited to traditional environmental hazards. *Cincinnati Specialty Underwriters Ins. Co. v. Energy Wise Homes, Inc.*, 2015 WL 1524206 (Vt. Apr. 3, 2015).

The underlying suit alleged bodily injury resulting from exposure to airborne chemicals from spray foam insulation. The foam company's insurer denied coverage on the basis of a pollution exclusion. A Vermont trial court ruled in favor of the policyholder, holding that the exclusion was intended to protect only against liability for traditional environmental contamination and that the term "pollutants" was ambiguous because "it was capable of such broad interpretation as to frustrate any reasonable purpose of the policy." The Vermont Supreme Court reversed.

The Vermont Supreme Court ruled that where the policy language is "clear and susceptible of only one possible interpretation," it must be enforced as written. Because the injuries at issue were allegedly caused by the dispersal of a toxic substance, the court concluded that the exclusion squarely applied. In enforcing the pollution exclusion, the court rejected several arguments frequently asserted by policyholders in this context: that the exclusion renders coverage illusory; that the policyholder's "reasonable expectations"

should dictate coverage; and that the historical background of the exclusion establishes limitations on its scope. The court noted, however, that its ruling was limited to surplus lines insurance in light of Vermont regulations requiring in-state general liability insurers to provide pollution coverage in most cases.

Bad Faith Alert:

Georgia Supreme Court Rules That Bad Faith Claim Is Precluded Where Policyholder Settled Without Insurer Consent

The Georgia Supreme Court ruled that a policyholder that violates a "consent to settle" clause is precluded from asserting bad faith refusal to settle against its insurer. *Piedmont Office Realty Trust, Inc. v. XL Specialty Ins. Co.*, 2015 WL 1773620 (Ga. Apr. 20, 2015).

Policyholder Piedmont was sued in a federal securities class action. Piedmont's defense costs in that case exceeded the limits of a primary policy and exhausted $4 million of a $10 million excess policy issued by XL Specialty Insurance Company. Piedmont sought XL's consent to settle the claims for the remaining $6 million in policy proceeds. XL agreed to contribute $1 million towards settlement. Without further notice to XL, Piedmont reached a court-approved settlement of the securities suit for $4.9 million. Thereafter, Piedmont sued XL for breach of contract and bad faith failure to settle. A Georgia federal district court dismissed Piedmont's complaint, citing to Piedmont's violation of the policy's consent to settle provision. The Georgia Supreme Court affirmed, stating that "Piedmont is precluded from pursuing this action against XL because XL did not consent to the settlement and Piedmont failed to fulfill the contractually agreed upon condition precedent."

Discovery Alert:

Sixth Circuit Rules That Federal Taxing Statute Allows Prevailing Party to Shift the Costs of Imaging a Computer's Hard Drive

United States litigants are entitled to limited reimbursement of costs, including duplicating costs, after prevailing in a federal court dispute. In a recent decision, the Sixth Circuit clarified that a federal statute permitting a prevailing party to recover reasonable and necessary litigation expenses allows recovery of the costs of imaging a computer hard drive or other physical storage device. *Colosi v. Jones Lang LaSalle Americas, Inc.*, 781 F.3d 293 (6th Cir. 2015).

After an employer prevailed in litigation initiated by a former employee, the employer filed a bill of costs pursuant to 28 U.S.C. § 1920, which the court clerk approved. The employee moved to reduce the bill, arguing that certain expenses were not taxable under the statute. In particular, the employee challenged the decision to tax the cost of imaging a computer's hard drive (*i.e.*, creating an identical copy of the hard drive), arguing that electronic discovery costs are not recoverable under the statute. The court disagreed. Section 1920 allows courts to tax "the costs of making copies of any materials where the copies are necessarily obtained for use in the case." The court concluded that "making copies" encompasses the imaging of a hard drive or other physical storage device. The court reasoned that "courts have long understood that the phrase 'making copies' fairly includes the production of imitations in a medium or format different than the original." Although the Third Circuit has reached a contrary conclusion, and has construed the phrase "making copies" to exclude the costs of imaging hard drives based on a "functional equivalent" analysis, the Sixth Circuit found such a construction "overly restrictive" and contrary to the statutory text.

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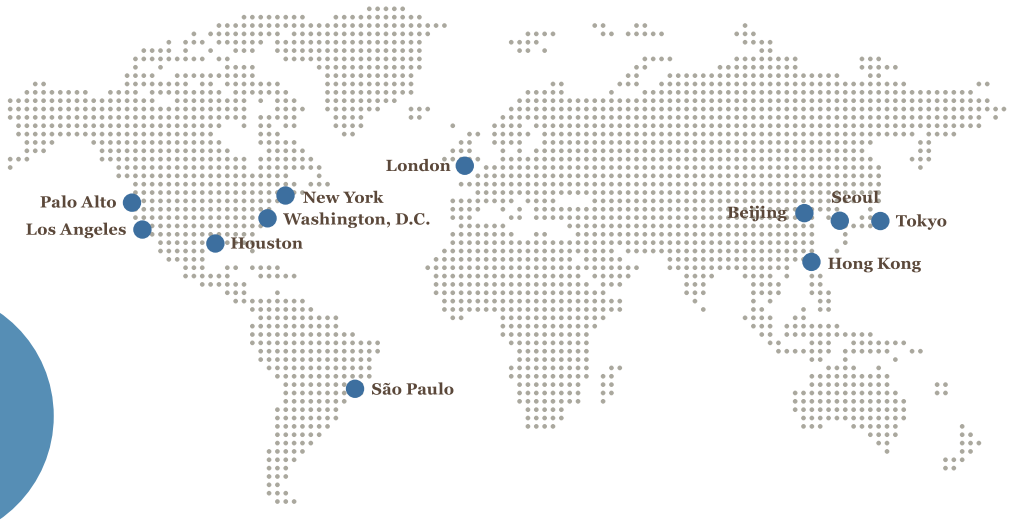

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