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INSURANCE LAW ALERT

APRIL 2014

This Alert discusses recent decisions relating to judicial intervention in an ongoing arbitration and the scope of personal and advertising injury coverage. In addition, we report on rulings addressing the implications of FDIC receivership for Directors and Officers coverage for insured bank officers. Finally, we discuss decisions relating to horizontal exhaustion, bad faith and the discoverability of reinsurance information, among others. Please "click through" to view articles of interest.

- ***Sixth Circuit Rules That Challenges to Arbitrator Partiality Must Await Final Award***
  The Sixth Circuit vacated an injunction halting a reinsurance arbitration, ruling that a court may not intervene in ongoing arbitration before a final arbitration award is issued. *Savers Prop. & Cas. Ins. Co. v. National Union Fire Ins. Co. of Pittsburgh, PA*, 2014 WL 1378134 (6th Cir. Apr. 9, 2014). *(click here for full article)*

- ***Two Courts Address Directors and Officers Coverage in the Context of FDIC Claims***
  Two courts recently addressed coverage issues implicated when the Federal Deposit Insurance Corporation, acting as receiver for a failed bank, seeks damages from the bank's officers and directors. *W Holding Co., Inc. v. AIG Insurance Co.-Puerto Rico*, 2014 WL 1280246 (1st Cir. Mar. 31, 2014); *OneBeacon Midwest Insurance Company v. FDIC.*, 2014 WL 869286 (N.D. Ga. Mar. 5, 2014). *(click here for full article)*

- ***Mississippi Court Finds No Personal and Advertising Injury Coverage for Misappropriation and Unfair Competition Claims***
  A Mississippi federal district court ruled that a general liability insurer had no duty to defend or indemnify misappropriation and unfair competition claims against a policyholder. *Nationwide Ins. Co. v. Lexington Relocation Servs. LLC*, 2014 WL 1213805 (N.D. Miss. Mar. 24, 2014). *(click here for full article)*

- ***Policy Exclusion for Violations of Consumer Protection Laws Bars Coverage for TCPA Claims, Says New York Court***
  A New York court ruled that a policy exclusion that bars coverage for consumer protection claims applies to telephone solicitation claims. *Certain Underwriters at Lloyd's, London v. Convergys Corp.*, 12 Civ. 08968 (S.D.N.Y. Mar. 25, 2014). *(click here for full article)*

- ***Delaware Court Predicts That New York Law Would Reject Horizontal Exhaustion for Excess Coverage Tiers***
  A Delaware court predicted that New York's highest court would rule that horizontal exhaustion does not apply to excess coverage tiers. *Viking Pump, Inc. v. Century Indem. Co.*, 2014 WL 1305003 (Del. Superior Ct. New Castle Cnty. Feb. 28, 2014). *(click here for full article)*

- ***Connecticut Court Rules That California Law Requires Horizontal Exhaustion of Primary Policies Prior to Excess Coverage***

  A Connecticut federal district court ruled that absent specific language requiring vertical exhaustion, California law required horizontal exhaustion of primary policies prior to the availability of excess coverage. *New England Reinsurance Corp. v. Ferguson Enter., Inc.*, No. 3:12cv948 (D. Conn. Apr. 8, 2014). *(click here for full article)*

- ***New York Court Rules That Primary Insurer's Settlement Constituted Bad Faith Against Excess Carrier***

  A New York federal district court ruled that a primary insurer's failure to tender policy limits in settlement negotiations with the policyholder constituted bad faith as to the excess insurer. *Quincy Mutual Fire Ins. Co. v. New York Central Mutual Fire Ins. Co.*, No. 3:12-CV-1041 (N.D.N.Y. Mar. 31, 2014). *(click here for full article)*

- ***Indiana Court Denies Policyholder's Motion to Compel Production of Reinsurance Communications***

  An Indiana federal district court ruled that a policyholder was not entitled to discovery of reinsurance communications. *National Union Fire Ins. Co. v. Mead Johnson & Co.*, 2014 WL 931947 (S.D. Ind. Mar. 10, 2014). *(click here for full article)*

Arbitration Alert:
Sixth Circuit Rules That Challenges to Arbitrator Partiality Must Await Final Award

Our October 2013 Alert discussed a Michigan district court decision issuing a preliminary injunction halting a reinsurance arbitration on the basis of potentially improper arbitrator conduct. This month, the Sixth Circuit vacated the ruling, finding that a court may not intervene in ongoing arbitration before a final arbitration award is issued. *Savers Prop. & Cas. Ins. Co. v. National Union Fire Ins. Co. of Pittsburgh, PA,* 2014 WL 1378134 (6th Cir. Apr. 9, 2014).

National Union entered into a reinsurance treaty with a group of ceding insurers (the "Plaintiffs"). An arbitration clause required all disputes to be decided by a panel of three arbitrators. However, the two party-selected arbitrators were unable to agree on an umpire. Therefore, they "cast lots" in order to choose an umpire, who disclosed a friendship and joint participation in an industry group with National Union's arbitrator. Following a hearing, the panel issued an interim award as to liability. Thereafter, National Union submitted documents in support of a claim for attorneys' fees, which indicated that its counsel had engaged in *ex parte* communications with its appointed arbitrator after the award had been issued. In addition, Plaintiffs' appointed arbitrator claimed that he was denied an opportunity to participate in deliberations regarding two orders that had been issued while he was on vacation. National Union refuted this contention, noting that efforts to contact Plaintiffs' arbitrator were unsuccessful and that, in any event, his participation would not have altered the orders because the treaty permitted a two-member majority to rule for the panel. Plaintiffs asked the panel to reconsider the award and to stay proceedings. When a majority of the panel denied these motions, Plaintiffs sought injunctive relief in federal court. The district court acknowledged the general prohibition against judicial review in ongoing arbitration proceedings, but nonetheless issued a preliminary injunction staying the arbitration. The Sixth Circuit reversed the judgment, dissolved the injunction, and remanded the matter for dismissal.

The Sixth Circuit ruled that the district court erred in entertaining an interlocutory challenge to an ongoing arbitration. The appellate court explained that under Michigan law (which governed the dispute and which mirrors the Federal Arbitration Act ("FAA") in relevant respects), there are only two stages at which a court may interject itself in arbitration proceedings: (1) at the outset of arbitration, in relation to "gateway matters" of arbitrability, such as whether there exists a valid agreement to arbitrate; and (2) at the conclusion of arbitration, in order to confirm, vacate or modify a final award. The court noted that although the law is

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"largely silent" with respect to judicial review at any stage between these two endpoints, most courts have ruled that the FAA prohibits interlocutory review of arbitration decisions. Therefore, the court concluded that absent a final arbitration award, Plaintiffs' motion was premature and the district court's intervention was in error.

Savers sends a strong message about the propriety of judicial intervention in ongoing arbitration. As discussed in our March 2011 Alert, the Seventh Circuit similarly reversed an Illinois district court decision that enjoined an arbitration on the basis of alleged arbitrator partiality. However, as the *Savers* court noted, specific contractual language may, in some cases, permit interlocutory judicial review of certain issues.

D&O Alert:

Two Courts Address Directors and Officers Coverage in the Context of FDIC Claims

Two courts recently addressed coverage issues implicated when the Federal Deposit Insurance Corporation ("FDIC"), acting as receiver for a failed bank, seeks damages from the bank's officers and directors.

In *W Holding Company, Inc. v. AIG Insurance Company-Puerto Rico*, 2014 WL 1280246 (1st Cir. Mar. 31, 2014), the First Circuit required an insurer to advance defense costs to bank officials under a directors and officers policy, citing uncertainty as to whether an "insured vs. insured" exclusion barred coverage for claims brought by the FDIC.

The coverage dispute arose out of a bank closure and investigation of bank officers. The FDIC, acting as receiver for the bank, sought damages from the officers for allegedly wrongful conduct. The officers notified Chartis of the claim and sought advancement of defense costs. Chartis denied coverage on the basis of the "insured vs. insured" exclusion, which barred coverage for claims brought "by, on behalf of or in the right of" any insured person. Chartis argued that the FDIC, as receiver, had stepped into the shoes of the insured bank, thereby triggering the exclusion. In turn, the officers sought a court order requiring Chartis to advance defense costs, which a Puerto Rico federal district court granted. The First Circuit affirmed, finding that the officers had established a likelihood of success on the merits as to the advancement of defense costs. Under Puerto Rico law, an insurer must advance defense costs if a complaint creates a "remote possibility" of coverage. The court concluded that the officers had established a likelihood of meeting

this threshold given the uncertainty as to whether the "insured vs. insured" exclusion applied to claims brought by the FDIC in a receiver capacity.

In *OneBeacon Midwest Insurance Compnay v. FDIC.*, 2014 WL 869286 (N.D. Ga. Mar. 5, 2014), a Georgia federal district court barred a D&O insurer from seeking a ruling that it had no duty to defend bank officers on the basis that it would run afoul of federal statutory law governing bank failures.

Following the insured bank's failure, the FDIC sought payment of civil damages from bank officials. OneBeacon, the bank's insurer, filed a declaratory judgment action seeking a ruling that coverage was barred on several bases, including the "insured vs. insured" exclusion. In a 2013 ruling, the court dismissed the suit, finding that One Beacon's claim

was precluded by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"). Under FIRREA, "no court may take any action . . . to restrain or affect the exercise of powers or function of the [FDIC] as a conservator or receiver." 12 U.S.C. § 1821(j). The court concluded that issuing a declaratory judgment as to OneBeacon's coverage obligations would affect the FDIC's ability to collect money on behalf of the bank because insurance proceeds would likely help satisfy any judgment against the officers and directors. Last month, the court affirmed its decision on reconsideration. The court cited to the "breadth of FIRREA" and rejected the notion that its ruling left OneBeacon without a remedy, noting that it could pursue its claims through FIRREA's administrative process.

OneBeacon appears to be a significant departure from a well-established body of D&O case law in which insurers have been permitted to challenge coverage obligations to directors and officers in the wake of a bank failure. An appeal may ensue; we will keep you posted on any developments in this matter.

Coverage Alerts:

Mississippi Court Finds No Personal and Advertising Injury Coverage for Misappropriation and Unfair Competition Claims

A Mississippi federal district court ruled that a general liability insurer had no duty to defend or indemnify misappropriation and unfair competition claims against a policyholder. *Nationwide Ins. Co. v. Lexington Relocation Serv., LLC*, 2014 WL 1213805 (N.D. Miss. Mar. 24, 2014).

Lexington Relocation Services ("LRS"), a corporate housing company, sued a former employee and Gum Tree Property Management, a competitor. LRS alleged that the former employee breached her contract with

LRS by sharing confidential company information with Gum Tree. The complaint alleged several causes of action, including misappropriation of trade secrets and unfair competition. Gum Tree sought defense and indemnification from Nationwide. In ensuing litigation, the parties cross-moved for summary judgment. The court granted Nationwide's motion in its entirety, rejecting several arguments frequently asserted by policyholders seeking personal and advertising injury coverage.

The use of trade secrets or confidential business information does not constitute disparagement: The court noted that the undefined policy term "disparage" does not encompass claims of improper customer solicitation or the use of a company's proprietary information, absent specific allegations relating to the belittling or criticizing of another's business.

The "right to privacy" does not extend to businesses: Although the underlying complaint alleged a violation of LRS's right to privacy, the policy provided coverage for offenses that violate "a person's right of privacy." Because the provision did not specifically extend coverage to "organizations" (as other policy provisions did), the court found no coverage.

Solicitation to a particular group of customers does not constitute "advertising": Under Mississippi law, advertising requires "widespread promotional activities directed to the public at large." Therefore, the court held that efforts directed at LRS's "current

or prospective clients" did not constitute advertising. The court also held that the underlying complaint did not implicate injury "arising from the use of another's advertising idea in your advertisement" because LRS's customer lists, pricing information and other confidential materials were not "advertising ideas."

Personal and advertising injury coverage requires a causal link between advertising and the alleged injury. The court explained that even where claims allege advertising, the policyholder must establish a causal relationship between the advertising activities and the alleged injuries. Where, as here, "the injury could have occurred independent of any advertising . . . [and the policyholder] would have still suffered the same injury and could have asserted the same claim with or without any 'advertising,' . . . there is no causal connection."

Finally, the court held that even if LRS could establish personal and advertising injury, coverage would be barred by the "Knowing Violation of Rights of Another" and "Breach of Contract" exclusions.

Policy Exclusion for Violations of Consumer Protection Laws Bars Coverage for TCPA Claims, Says New York Court

In recent years, coverage litigation arising out of fax blasting and telephone solicitation in violation of the Telephone Consumer Protection Act ("TCPA") has proliferated. Case law in this context has focused largely on two issues: (1) whether TCPA claims allege a "violation of privacy" within the scope of personal and advertising injury coverage; and (2) whether statutory TCPA damages are punitive in nature, and therefore uninsurable or otherwise contractually excluded. *See* June and September 2013 Alerts; October 2011 Alert; March 2010 Alert. In a recent decision, a New York court addressed a related issue—namely, whether a policy exclusion that bars coverage for consumer protection claims applies to TCPA/telephone solicitation claims. *Certain Underwriters at Lloyd's, London v. Convergys Corp.*, 12 Civ. 08968 (S.D.N.Y. Mar. 25, 2014).

In *Convergys*, an underlying class action complaint alleged TCPA violations based on unsolicited autodialed calls to cellular telephones. The insurer reserved its right to deny coverage and thereafter brought a declaratory judgment action seeking a determination that it had no obligation to defend, settle or pay a judgment in the underlying action. The court granted the insurer's summary judgment motion based on a policy exclusion that barred coverage for, among other things, claims arising out of "violation[s] of consumer protection laws (except for consumer privacy protection laws under Insuring Clause 1.C)." The court held that

this exclusion applied squarely to the circumstances of the case because "there can be no reasonable difference of opinion that the [underlying TCPA class action] was a claim for a violation of consumer protection law." The court further held that the parenthetical exception to the exclusion did not operate to restore coverage. The court explained that the exception did not restore coverage for all privacy-related allegations, but rather, pursuant to Clause 1.C, was limited to allegations pertaining to the policyholder's failure to comply with a privacy policy that specifically provides a person with the ability to opt out of the policyholder's use of personal information. Here the class action complaint did not seek to recover for the policyholder's failure to comply with a privacy policy, and instead was

directed squarely at the consumer protection aspect of the TCPA. Furthermore, the court held that even assuming that the policyholder engaged in conduct that violated a corporate privacy policy, the complaint and the settlement were completely unrelated to such non-compliance. Lloyds is represented in this matter by STB partner Bryce Friedman.

Exhaustion Alerts:

Delaware Court Predicts That New York Law Would Reject Horizontal Exhaustion for Excess Coverage Tiers

Addressing a matter of first impression, a Delaware court predicted that New York's highest court would rule that horizontal exhaustion does not apply to excess coverage tiers. *Viking Pump, Inc. v. Century Indem. Co.*, 2014 WL 1305003 (Del. Superior Ct. New Castle Cnty. Feb. 28, 2014).

In this longstanding asbestos-related coverage litigation, the court had previously ruled that the proper method of allocation among insurers was "all sums" (*see* December 2009 Alert), that New York's injury-in-fact trigger applied, and that under New York's horizontal exhaustion rule, all underlying primary polices must be exhausted before excess coverage is triggered. In its most recent ruling, the court addressed whether horizontal exhaustion applied to every layer of Viking's insurance tower, or only to the primary and umbrella layers. The court endorsed the latter view, holding that horizontal exhaustion does not govern the timing of payment among excess tiers in continuous injury cases.

New York law governed the exhaustion issue. However, finding no applicable New York case law, the court relied primarily on a California trial court decision, *Kaiser Aluminum & Chemical Corp. v. Certain Underwriters at Lloyd's, London*, No. 312415 (Cal. Super. Ct. June 13, 2003). *Kaiser* held that while horizontal exhaustion applied to the primary level of coverage, vertical exhaustion applied to excess layers (*i.e.*, an excess policy is excess only to the policy directly below it). The court also reasoned that because horizontal exhaustion generally operates to limit coverage, the insurers bear the burden of proving its applicability. Here, the court held that the excess insurers did not "demonstrate a legal or policy-based requirement for horizontally exhausting the excess policies." Importantly, the court did not reject horizontal exhaustion for excess layers in all cases, and noted that a contrary result might be reached under another jurisdiction's law and/or under different factual circumstances.

Connecticut Court Rules That California Law Requires Horizontal Exhaustion of Primary Policies Prior to Excess Coverage

A Connecticut federal district court ruled that absent specific language requiring vertical exhaustion, California law required horizontal exhaustion of primary policies prior to the availability of excess coverage. *New England Reinsurance Corp. v. Ferguson Enter., Inc.*, No. 3:12cv948 (D. Conn. Apr. 8, 2014). In this case, the policyholder sought coverage under primary and excess policies for asbestos-related losses. New England Reinsurance, an excess insurer, filed a declaratory judgment action seeking a ruling as to the obligations of various primary and excess insurers. The court granted New England Reinsurance's summary judgment motion on horizontal exhaustion. The court reasoned that the language contained in the excess policies (several of which defined underlying limit as "the underlying insurance listed in the Schedule A . . . plus the applicable limits of any other underlying insurance collectible") did not support application of vertical exhaustion.

Bad Faith Alert:

New York Court Rules That Primary Insurer's Settlement Constituted Bad Faith Against Excess Carrier

A New York federal district court ruled that a primary insurer's failure to tender policy limits in settlement negotiations with the policyholder constituted bad faith as to the excess insurer. *Quincy Mutual Fire Ins. Co. v. New York Central Mutual Fire Ins. Co.*, No. 3:12-CV-1041 (N.D.N.Y. Mar. 31, 2014).

New York Central issued an automobile policy with a $500,000 limit to Randolph Warden. Quincy Mutual issued a homeowners policy that provided $1 million in excess coverage. Warden was sued in connection with a car accident that resulted in serious injuries to the other driver. After Warden was found liable, New York Central offered $75,000 in settlement. The claimant rejected the offer and demanded policy limits of $500,000. After an appellate court affirmed the ruling, the claimant increased her demand to $3.5 million. New York Central's offer remained at $75,000 despite documentation as to the severity and monetary value of the claimant's injuries and lost wages. Four years after its initial offer, New York Central offered its policy limits. Quincy Mutual tendered its policy limits as well, and the case settled for approximately $1.5 million, nearly $500,000 of which represented prejudgment interest. Quincy Mutual demanded reimbursement of the interest portion from New York Central. New York Central refused and litigation ensued.

Under New York law, a primary insurer defending a case owes a duty of good faith to excess carriers. Although there is a strong presumption against bad faith, the presumption may be overcome where a primary insurer acts in "gross disregard to the interests of the excess carrier." The court concluded that Quincy Mutual had established bad faith because, among other things, there was no "serious doubt"

as to Warden's liability and damage estimates well exceeded New York Central's policy limits. Therefore, the court awarded Quincy Mutual $1 million (the full amount it paid), plus interest. The court rejected the argument that Quincy Mutual contributed to the lack of settlement by failing to participate in negotiations prior to New York Central's tender of policy limits. In this respect, the decision illustrates that although an excess carrier's conduct may "have some relevance in a bad-faith action," "the law places no legal obligation on an excess carrier [ ] to negotiate a claim unless and until primary coverage is exhausted."

The ruling also demonstrates the potential relevance of reinsurance in the context of bad faith claims against a primary insurer. The court noted that bad faith was "even more pronounced in this case due to the fact that, after receiving reimbursement from [its reinsurer], New York Central paid only $132,479 . . . . In other words, while it exposed Quincy Mutual to liability for up to $1 million, and its insured to potential excess liability above $1.5 million, New York Central risked only payment of an additional amount of $57,479 above its $75,000 offer."

Discovery Alert:

Indiana Court Denies Policyholder's Motion to Compel Production of Reinsurance Communications

The question of whether reinsurance-related information is relevant, and thus discoverable, in a coverage dispute between a policyholder and its insurer is typically a fact-dependent inquiry relating to how the information sought relates to the particular claims and legal issues presented. Generally speaking, courts have been disinclined to allow discovery of a ceding insurer's communications with its reinsurer. In a recent decision, an Indiana federal district court followed this trend, reversing a Magistrate Judge's order that had granted a policyholder's motion to compel the production of reinsurance communications. *National Union Fire Ins. Co. v. Mead Johnson & Co.*, 2014 WL 931947 (S.D. Ind. Mar. 10, 2014). The court agreed with the insurers that reinsurance communication files would not lead to the discovery of admissible evidence about the insurers' "own definition of claims which could fall under its insurance agreements." The court explained that because the policy terms were unambiguous, extrinsic evidence such as reinsurer communications was irrelevant to the parties' dispute as to the scope of coverage under the policy.

Simpson Thacher has been an international leader in the practice of insurance and reinsurance law for more than a quarter of a century. Our insurance litigation team practices worldwide.

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