Simpson Thacher

Insurance Law Alert

January 2018

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The Florida Supreme Court ruled that a statutory process for resolving construction defect claims is a "suit" that triggers an insurer's duty to defend under a general liability policy. *Altman Contractors, Inc. v. Crum & Forster Specialty Ins. Co.*, 2017 WL 6379535 (Fla. Dec. 14, 2017). (Click here for full article)

"We go to them for their experience; their work product is flawless."

***–Chambers USA* 2017, quoting a client**

Two Courts Rule That Reservation Of Rights Does Not Give Rise To Conflict Of Interest

An Illinois appellate court and a California federal district court both ruled that an insurer's reservation of rights did not create a conflict of interest entitling the policyholder to independent counsel at the insurer's expense. *Bean Products, Inc. v. Scottsdale Ins. Co.*, 2018 WL 522627 (Ill. App. Ct. Jan. 22, 2018); *Tokio Marine Specialty Ins. Co. v. City of Laguna Beach*, 2017 WL 6512226 (C.D. Cal. Dec. 18, 2017). (Click here for full article)

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A West Virginia federal district court ruled that rescission of an insurance policy was warranted but that the insurer was not entitled to reimbursement of defense costs expended by the insurer prior to rescission. *ALPS Property & Casualty Ins. Co. v. Turkaly*, 2018 WL 385195 (S.D.W.Va. Jan. 11, 2018). (Click here for full article)

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The Second Circuit ruled that a professional services exclusion relieved D&O insurers from funding an underlying settlement in a class action suit against NASDAQ. *Beazley Ins. Co., Inc. v. Ace American Ins. Co.*, 2018 WL 492693 (2d Cir. Jan. 22, 2018). (Click here for full article)

Mississippi Court Allows Bad Faith Claim To Proceed Despite Dismissal Of Breach Of Contract Claim

A Mississippi federal district court refused to dismiss a bad faith claim against an insurer, notwithstanding the dismissal of a breach of contract claim arising out of the same underlying conduct. *Heritage Props., Inc. v. Ironshore Specialty Ins. Co.*, 2018 WL 506483 (S.D. Miss. Jan. 22, 2018). (Click here for full article)

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A West Virginia federal district court ruled that claims alleging sexual and physical abuse, malnourishment and educational neglect constitute multiple occurrences. *Brotherhood Mutual Ins. Co. v. Bible Baptist Church*, 2017 WL 6061979 (S.D.W.Va. Dec. 7, 2017). (Click here for full article)

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The Eleventh Circuit ruled that an additional insured endorsement provides coverage only when underlying liability was caused in whole or in part by the named insured. *Employers Mutual Cas. Co. v. Shivam Trading, Inc.*, 2018 WL 365216 (11th Cir. Jan. 11, 2018). (Click here for full article)

Florida Court Rules That Insurer Implicitly Waived Equitable Subrogation Claim

A Florida district court dismissed an equitable subrogation claim brought by one insurer against another, finding that the insurer seeking contribution failed to establish coverage under the other insurer's policy, and in any event, had waived its right to seek such contribution. *Privilege Underwriters Reciprocal Exchange v. The Hanover Insurance Grp.*, 2018 WL 477277 (S.D. Fla. Jan. 19, 2018). (Click here for full article)

Duty To Defend Alert:

Florida Supreme Court Rules That Statutory Process For Construction Defect Claims Is A "Suit" Triggering Insurer's Duty To Defend

Answering a question certified by the Eleventh Circuit, the Florida Supreme Court ruled that a statutory process for resolving construction defect claims is a "suit" that can trigger defense obligations under a general liability policy. *Altman Contractors, Inc. v. Crum & Forster Specialty Ins. Co.*, 2017 WL 6379535 (Fla. Dec. 14, 2017).

Altman, the general contractor for the construction of Sapphire Condominiums, was insured under consecutive general liability policies issued by Crum & Forster. During the coverage period, Sapphire served Altman with numerous notices of claim under chapter 558, Florida Statutes, which sets forth a process for resolving construction defect claims and is a condition precedent to filing a lawsuit. Altman sought defense and indemnity from Crum & Forster, which the insurer denied on the basis that the statutory process was not a "suit" under the policy, defined as "a civil proceeding in which damages . . . are alleged," an arbitration, or "[a]ny other alternative dispute resolution proceeding in which such damages are claimed and to which the insured submits with our consent." Thereafter, Altman sought a declaration that Crum & Forster was obligated to defend and indemnify the claims and moved for partial summary judgment on whether the duty to defend was triggered by the initiation of the statutory procedure.

After the Florida district court ruled that the chapter 558 process was not a "suit," Altman appealed to the Eleventh Circuit, which certified the following question: "Is the notice and repair process set forth in chapter 558, Florida Statutes, a suit within the meaning of the commercial general liability policy issued by C&F to Altman?" The Florida Supreme Court accepted certification and answered the question in the affirmative.

The Florida Supreme Court ruled that the chapter 558 process is not a "civil proceeding" under the policy because, although the statute requires a claimant to serve a notice of claim prior to filing suit, the recipient's participation is not mandatory and the process does not take place in a court of law or involve any type of adjudicatory body. However, the court concluded that the chapter 558 process does fall within the scope of "any other alternative dispute resolution proceeding," noting that the Legislature expressly described the statute as an "effective alternative dispute resolution mechanism." The court also held that the damages component of the suit requirement was met because chapter 558 provides for damage awards.

The court declined to address whether Crum & Forster had consented to the proceeding (as required by the policy's definition of "suit" to trigger the insurer's duty to defend), explaining that it was outside the scope of the certified question. The court remanded the matter for a factual determination.

Conflict Of Interest Alert:

Two Courts Rule That Reservation Of Rights Does Not Give Rise To Conflict Of Interest

An Illinois appellate court affirmed a trial court decision holding that an insurer's reservation of rights as to a punitive damage claim did not automatically create a conflict of interest entitling the policyholder to independent counsel at the insurer's expense. *Bean Products, Inc. v. Scottsdale Ins. Co.*, 2018 WL 522627 (Ill. App. Ct. Jan. 22, 2018).

A suit filed against Bean Products alleged that it marketed and sold home-gym products in violation of another entity's copyright and trademark. Bean retained counsel, who provided notice of the suit to Scottsdale, Bean's liability insurer. Scottsdale appointed counsel to defend the underlying suit and issued a limited reservation of rights with respect to the underlying claim for punitive and exemplary damages. Scottsdale further advised that it was not waiving "any additional defenses which further investigation will reveal." Bean argued that the reservation of rights created a conflict of interest entitling Bean to retain independent counsel. After the underlying suit was settled, Bean sued Scottsdale seeking a declaration

that Scottsdale was obligated to reimburse Bean for the fees incurred in paying for independent counsel. A trial court ruled in favor of Scottsdale, finding no conflict of interest and no right to independent counsel. The appellate court affirmed.

Under Illinois law, a conflict exists if "the insurer's interests would be furthered by providing a less than vigorous defense to the [underlying] allegations." Bean argued that Scottsdale had an interest in providing a less than vigorous defense to the punitive damages claim because any such damages would be outside the scope of coverage. The court disagreed, finding that the punitive damages issue created only an "attenuated, hypothetical conflict" rather than an actual one. The court distinguished precedent in which a reservation of the right to disclaim coverage for punitive damages gave rise to a conflict of interest where the underlying plaintiff had sought minimal compensatory damages and substantial punitive damages. Noting that the underlying complaint against Bean did not demand "a disproportionate ratio of compensatory to punitive damages," the court emphasized that a reservation as to a punitive damage claim does not automatically give rise to a conflict under Illinois law.

The court also rejected Bean's assertion that the "open ended" nature of Scottsdale's reservation of rights created a conflict of interest. Bean contended that the reservation allowed Scottsdale to "lay the groundwork" for a later coverage denial while still controlling the defense of the underlying suit. Dismissing these contentions, the court held that Bean failed to show a divergence in the parties' interests and, at best, demonstrated only a remote possibility that a conflict could develop.

A California federal district court reached the same conclusion in *Tokio Marine Specialty Ins. Co. v. City of Laguna Beach*, 2017 WL 6512226 (C.D. Cal. Dec. 18, 2017), ruling that a reservation of rights as to a "your insured location" policy exclusion did not create an actual conflict of interest between the parties even though the location of the cause of damage was at issue in the underlying dispute.

The City of Laguna Beach sought defense and indemnity from Tokio Marine for underlying claims arising out of a sewer backup. Tokio Marine agreed to defend under a reservation of rights. In its reservation, Tokio Marine cited several possible bases for non-coverage, including the contention that the contamination at issue did not satisfy the policy's "your insured location" requirement. In response, the City demanded that Tokio Marine pay for independent counsel based on a conflict of interest. The City argued that a conflict existed because the precise location of the sewer blockage was a primary issue in dispute in both the underlying and coverage actions. The court disagreed and denied the City's partial summary judgment motion.

Section 2860 of the California Civil Code requires an insurer to provide independent counsel to the insured if a conflict of interest exists. The court concluded that no such conflict existed here because the interests of the City and Tokio Marine were aligned in disputing the City's liability. The court explained:

> For an actual conflict to materialize, Tokio Marine's appointed counsel would have to advocate that a blockage in the main line, rather than a trunk line, was the causal factor leading to the backup. Such a position would necessarily concede the City's liability. The City provides no evidence to support why appointed counsel would take such a position when a defense that denies the City's liability would both align with the interests of the City and Tokio Marine and fulfill counsel's fiduciary duties to both clients.

The court also rejected the City's contention that a conflict existed by virtue of the declaratory judgment action filed by Tokio Marine against the City to determine its rights and obligations, noting that "litigation alone does not, as a matter of law, create a conflict of interest that entitles the City to independent counsel."

Rescission Alerts:

Policyholder's Misrepresentation In Application Warrants Rescission Notwithstanding Confusing Question, Says Ninth Circuit

The Ninth Circuit ruled that an insurer was entitled to rescind a policy based on the policyholder's misrepresentation in the application, notwithstanding that the application question at issue was grammatically confusing. *Western World Ins. Co. v. Professional Collection Consultants*, 2018 WL 259309 (9th Cir. Jan. 2, 2018).

In 2013, FBI agents executed a search warrant at the offices of Professional Collection Consultants ("PCC") and issued subpoenas to several PCC employees. In 2014, PCC applied for and obtained D&O insurance from Western World Insurance. In 2015, Western sought to rescind the policy based on a material misrepresentation relating to the following question: "None of the individuals to be insured under any Coverage Part (the 'Insured Persons') have a basis to believe that any wrongful act, event, matter, fact, circumstance, situation, or transaction, might reasonably be expected to result in or be the basis of a future claim?" PCC answered "no" to this question. A California federal district court granted Western's summary judgment motion for rescission and the Ninth Circuit affirmed.

The Ninth Circuit held that rescission was appropriate because PCC's answer was a material misrepresentation in light of the prior FBI investigation. The court rejected PCC's contention that the response was not a misrepresentation because when read literally, the negative response was grammatically accurate (*i.e.*, PCC was aware of circumstances that could lead to a claim). The court reasoned that the overall context of the question indicated that the question was asking about possible claims, even though it was inartfully worded. In particular, the court noted that the application instructions indicated that a "yes" response would require additional information and could affect the terms and conditions offered. The court also rejected PCC's assertion that the answer was immaterial because the question was only required for applicants seeking increased policy limits. Given the relevance of the FBI investigation to the insurer's assumption of risk, the court deemed the information material as a matter of law.

West Virginia Court Denies Insurer's Claim For Defense Cost Reimbursement Following Rescission Of Policy

A West Virginia federal district court ruled that rescission of an insurance policy was warranted but that the insurer was not entitled to reimbursement of defense costs expended by the insurer prior to rescission. *ALPS Property & Casualty Ins. Co. v. Turkaly*, 2018 WL 385195 (S.D.W.Va. Jan. 11, 2018).

Attorney Michael Turkaly sought coverage from professional liability insurer ALPS for malpractice claims filed against him during the policy period. ALPS initially defended Turkaly under a reservation of rights, but later sought to rescind the policy based on alleged misrepresentations in the application. ALPS filed the instant suit, seeking a declaration as to rescission and reimbursement of costs incurred in defending Turkaly in the underlying suit.

The court ruled that rescission was proper under West Virginia law because Turkaly made material misrepresentations in his policy—namely, that he was unaware of any facts that could form the basis of a claim against him, when in actuality, he had knowledge of the underlying suit against him. However, the court denied ALPS's claim that it was entitled to reimbursement of defense costs under the policy. The court reasoned that "[b]ecause the 2016 Policy is rescinded and void *ab initio*, it cannot form the basis of liability, for either ALPS or Michael Turkaly."

Coverage Alert:

Finding That NASDAQ Investors Are "Customers," Second Circuit Rules That Professional Services Exclusion Bars Coverage For Class Action Settlement

The Second Circuit ruled that a professional services exclusion relieved D&O insurers from funding an underlying settlement in a class action suit against NASDAQ. *Beazley Ins. Co., Inc. v. Ace American Ins. Co.*, 2018 WL 492693 (2d Cir. Jan. 22, 2018).

The coverage dispute arose out of a class action suit against NASDAQ based on "technical failures" in executing the IPO for Facebook, which resulted in the improper processing of trade orders. The suit asserted federal securities fraud claims and state law negligence claims. The suit was ultimately settled for $26.5 million. Beazley Insurance, NASDAQ's excess E&O insurer, paid its policy limit of $15 million under an agreement in which NASDAQ assigned Beazley its rights against Ace and Illinois National, NASDAQ's D&O insurers. Beazley sued the D&O insurers seeking coverage for the settlement under their policies. A New York federal district court granted the D&O insurers' summary judgment motion, ruling that the underlying claims were within the scope of a professional services exclusion in the D&O policies. The Second Circuit affirmed.

The exclusion provides that the insurer "shall not be liable for Loss on account of any Claim . . . by or on behalf of a customer or client . . . arising out of, or attributable to the rendering or failure to render professional services." Beazley argued that the exclusion does not apply because (1) the retail investors who sued NASDAQ in the underlying class action are not customers or clients, and (2) the underlying federal securities claims are not based on the rendering or failure to render professional services. The Second Circuit rejected both assertions.

Although the policy does not define "customer," the Second Circuit concluded that the term unambiguously encompasses NASDAQ's retail investors, agreeing with the district court's reliance on "the customs, practices, usages and terminology as generally understood in the particular trade or business" and noting that the "vast majority" of federal courts have deemed retail investors to be "customers" of a stock exchange. In addition, the Second Circuit ruled that the underlying securities claims arose out of the rendering of professional services. Beazley argued that NASDAQ's alleged misstatements and omissions in violation of federal securities law were essentially advertising activities and thus do not fall within the scope of professional services. The court disagreed, stating that "[t]he flaw in this argument is that the [class action] plaintiffs could not win at trial merely by showing that NASDAQ made false and misleading statements as to its capabilities. . . . The [underlying complaint] recognizes this, and pleads loss causation based on failures in the technical service provided by NASDAQ." As the court explained, such alleged failures fall squarely within the ambit of professional services.

Bad Faith Alert:

Mississippi Court Allows Bad Faith Claim To Proceed Despite Dismissal Of Breach Of Contract Claim

A Mississippi federal district court refused to dismiss a bad faith claim against an insurer, notwithstanding the dismissal of a breach of contract claim arising out of the same underlying conduct. *Heritage Props., Inc. v. Ironshore Specialty Ins. Co.*, 2018 WL 506483 (S.D. Miss. Jan. 22, 2018).

Heritage, a property management company, sought coverage for mold-related claims under a general liability policy issued by Ironshore. Ironshore assigned claim administration to York Risk Services Group. Several months later, Heritage learned that a default judgment had been issued against it. In response to inquiries made by Heritage, York initially claimed that it had sent a coverage denial several months earlier by certified mail, and that the letter was unclaimed and returned. York represented that it then sent a second denial via regular mail. York later admitted that the disclaimer had never been sent via certified mail. Thereafter, Heritage sued Ironshore, York and Ironshore's underwriting company, asserting breach of contract and bad faith, among other claims.

The court dismissed the breach of contract claim on the basis of an "organic pathogen" exclusion, which provides that Ironshore has no duty to defend Heritage against claims arising out of harm attributable to "any type of bacteria, virus, fungi, mold, mushroom, or mycotoxin." The court reasoned that the mold-related claims fall squarely within the scope of this exclusion and thus Ironshore had no duty to defend the underlying suit.

The court declined to dismiss the breach of the duty of good faith and fair dealing claim. The court rejected Heritage's assertion that Ironshore breached the duty of good faith and fair dealing by failing to investigate the claim, explaining that the duty to investigate arises in first-party insurance cases but not in third-party claims where the insurer generally has no duty to investigate beyond the allegations in the complaint. However, noting the uncertainty of whether Mississippi law recognizes a bad faith claim based on an insurer's failure to provide a denial of coverage, the court found that the allegations in the complaint sufficiently stated a plausible bad faith claim based on York's failure to provide (and misrepresentations regarding) a coverage denial.

Number Of Occurrences Alert:

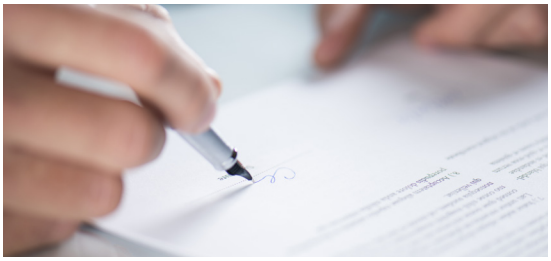
Applying "Triggering" Approach, West Virginia Court Rules That Sexual And Physical Abuse Claims Constitute Multiple Occurrences

A West Virginia federal district court ruled that claims alleging sexual and physical abuse, malnourishment and educational neglect constitute multiple occurrences. *Brotherhood Mutual Ins. Co. v. Bible Baptist Church*, 2017 WL 6061979 (S.D.W.Va. Dec. 7, 2017).

Two students at a boarding school run by the insured church filed separate complaints alleging abuse, malnourishment and educational neglect. Both complaints also alleged that the church was negligent in its hiring and supervision of the school staff. Brotherhood Mutual, the church's insurer, sought a declaration that the students' claims constitute one occurrence under the policy. The court disagreed, ruling that the claims constitute five separate occurrences under West Virginia law.

The court applied a "triggering approach" that focuses on "the event for which the insured becomes liable, not some antecedent cause of the injury," in order to determine the number of occurrences. The court reasoned that each student's sexual abuse claim constituted a separate occurrence because the victim and alleged perpetrator were different in each case. The court further explained that the events that triggered liability were the acts of each alleged perpetrator, rather than the church's negligent supervision. However, the court ruled that "each subsequent instance of sexual abuse by one perpetrator against one child falls under the same occurrence as the first instance of sexual abuse." In so ruling, the court relied on the policy's definition of "occurrence" ("an accident and includes repeated exposure to similar conditions") as well as a separate policy provision stating that multiple sexual acts will be considered a single act if undertaken by the same perpetrator.

The court also held that the physical abuse claims constitute a separate occurrence from the sexual abuse claims. The court reasoned that the physical abuse claims did not arise out of the same conditions as the sexual abuse claims and were based on the alleged conduct of a different staff member. However, unlike the sexual abuse claims, the court determined that all physical abuse claims comprise a single occurrence because liability was triggered by a single source – the abusive behavior of a single individual. Applying the same reasoning, the court concluded that the malnutrition claims and the educational neglect claims were separate occurrences from the sexual and physical abuse claims, but that all malnutrition claims were a single occurrence (based on the alleged failure to feed the students) and all educational neglect claims were a single occurrence (based on the school's implementation of an improper curriculum).



Additional Insured Alert:

Eleventh Circuit Rules That Additional Insured Endorsement Limits Coverage To Liability Caused By Named Insured

Affirming a Georgia federal district court decision, the Eleventh Circuit ruled that an additional insured endorsement provides coverage only when underlying liability was caused in whole or in part by the named insured. *Employers Mutual Cas. Co. v. Shivam Trading, Inc.*, 2018 WL 365216 (11th Cir. Jan. 11, 2018).

Shivam leased a store from Sidhi Investment Corporation. Both parties were sued in a slip-and-fall injury suit, but the claims against Sidhi were dismissed on summary judgment. Shivam sought additional insured coverage under a policy issued to Sidhi. The insurer denied coverage on the basis that the underlying claims were outside the scope of coverage provided by the additional insured endorsement. A Georgia district court agreed and granted the insurer's summary judgment motion. The Eleventh Circuit affirmed.

The additional insured endorsement provides coverage for parties listed as additional insureds, "but only with respect to liability . . . caused, in whole or in part, by your acts or omissions . . . or in connection with your premises owned by or rented to you." The parties disputed the meaning of "you" and "your" in the endorsement. Shivam argued that those terms are ambiguous as to whether they refer only to Sidhi as the named insured, or to Shivam (as an additional insured as well). In contrast, the insurer contended that "you" and "your" refer only to the named insured, as expressly stated in the policy's preamble. The court agreed with the insurer, holding that the policy unambiguously limits additional insured coverage to liability caused in whole or in part by Sidhi, the named insured. Because Sidhi was found not liable for the underlying personal injury, the court held that the insurer had no duty to defend Shivam as an additional insured.

Subrogation Alert:

Florida Court Rules That Insurer Implicitly Waived Equitable Subrogation Claim

A Florida district court dismissed an equitable subrogation claim brought by one insurer against another, finding that the insurer seeking contribution failed to establish coverage under the other insurer's policy, and in any event, had waived its right to seek such contribution. *Privilege Underwriters Reciprocal Exchange v. The Hanover Insurance Grp.*, 2018 WL 477277 (S.D. Fla. Jan. 19, 2018).

The dispute arose out of a defamation suit filed against Alan Dershowitz. During the relevant time frame, Dershowitz was insured under a homeowner's policy issued by Privilege and a business owner's policy issued by Hanover. The defamation suit was settled, with both insurers contributing. Thereafter, Privilege filed an equitable subrogation claim against Hanover seeking to recover the amount it contributed to the settlement. Following a bench trial, the court concluded that Privilege failed to prove Hanover's liability under its policy and that in any event, Privilege waived its right to equitable subrogation by volunteering settlement payments without reserving its right to later recover them.

The court held that Privilege's equitable subrogation claim required a threshold demonstration that Hanover's policy provided coverage for the settled claims. The court concluded that Privilege failed to make such a showing because Hanover had disputed coverage in a reservation of rights to Dershowitz and its coverage obligations "still remain unresolved." In any event, the court ruled that Privilege volunteered settlement funds and waived its right to seek equitable contribution. In so ruling, the court noted that the insurers did not enter into a subrogation agreement and that Privilege did not preserve a cause of action against Hanover for indemnity, contribution or subrogation. Further, the court emphasized that in its reservation of rights letter to Dershowitz, Privilege cited only an intentional acts exclusion and did not raise a priority-of-coverage issue with respect to the Hanover policy.

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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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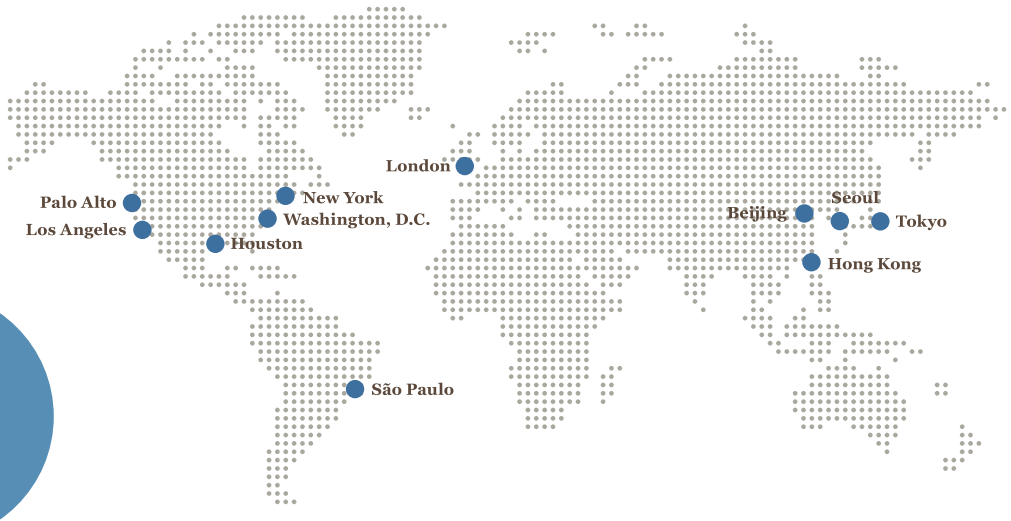

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