SIMPSON THACHER

INSURANCE LAW ALERT

DECEMBER 2010

This Alert addresses a variety of decisions relating to D&O coverage, pollution exclusions and the nature and scope of arbitration awards. Please "click through" to view articles of interest. Happy Holidays!

- ***Fifth Circuit Strictly Enforces Non-Assignment Clause, Rejecting Transfer of Insurance Coverage***
  The Fifth Circuit ruled that an asset purchase agreement did not transfer insurance coverage under a general liability policy to the purchasing company where that policy contained a non-assignment provision and the asset purchase agreement expressly excluded insurance policies from transfer. *Keller Foundations, Inc. v. Wausau Underwriters Ins. Co.*, 2010 WL 4673026 (5th Cir. Nov. 19, 2010). *Click here for full article*.

- ***First Circuit Rules that "Bump Up" Clause Bars Coverage for Certain Settlement Payments***
  The First Circuit ruled that a "bump up" clause in a directors and officers insurance policy barred coverage for settlement monies paid to resolve claims against Genzyme Corp, but did not preclude coverage for settlement amounts paid to indemnify individual directors and officers. *Genzyme Corp. v. Federal Ins. Co.*, 622 F.3d 62 (1st Cir. 2010). *Click here for full article*.

- ***Florida Court Rules that Pollution Exclusion Bars Coverage for Negligent Hiring Claims***
  A Florida district court ruled that a general liability insurer had no duty to defend or indemnify a lawsuit alleging claims of negligent hiring and supervision. *Nationwide Mut. Ins. Co. v. Lang Mgmt., Inc.*, 2010 WL 3958654 (S.D. Fla. Oct. 7, 2010). The court reasoned that because the negligent hiring and supervision claims were causally related to alleged pollution activities, the pollution exclusion barred coverage. *Click here for full article*.

- ***Tenth Circuit Affirms that Dirt and Rock are Pollutants Within Meaning of Exclusion***
  The Tenth Circuit affirmed that property damage caused by dirt, rock and soil fell within the scope of a total pollution exclusion, thereby relieving a general liability insurer of its duty to defend and indemnify the insured. *New Salida Ditch Co., Inc. v. United Fire & Cas. Ins. Co.*, 2010 WL 4250004 (10th Cir. Oct. 28, 2010). *Click here for full article*.

- ***Law Firm's Unwitting Participation in Check Passing Scheme Does Not Constitute "Professional Services"***
  A federal court in South Carolina ruled that a law firm's actions, undertaken in connection with its unwitting participation in a check passing scheme, do not constitute professional services covered by the law firm's professional liability insurer. *Bradford & Bradford, P.A. v. Attorneys Liab. Protection Soc., Inc.*, 2010 WL 4225907 (D.S.C. Oct. 20, 2010). *Click here for full article*.

- ***Ninth Circuit Limits Supreme Court's Ruling Prohibiting Immediate Appeals of Certain Discovery Orders***
  The Ninth Circuit ruled that a disinterested third-party custodian of privileged documents may file an immediate appeal of a trial court's adverse discovery order. *United States v. Krane*, 2010 WL 4260978 (9th Cir. Oct. 29, 2010). The Ninth Circuit reasoned that where the privilege-holder is a disinterested third party, an interlocutory appeal might be the privilege-holder's only opportunity to seek review of the district court's ruling regarding attorney-client privilege. *Click here for full article*.

- ***Third Circuit Affirms Order Vacating Arbitration Award in Reinsurance Dispute on the Basis that Arbitration Panel Exceeded its Authority***
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- ***Arbitrator's Failure to Disclose the Nature of His Legal Practice Requires Vacatur of Arbitration Award***
  A California Court of Appeal ruled that an arbitrator presiding over an attorneys' fee dispute should have revealed that the focus of his legal practice was the representation of lawyers engaged in fee disputes with former clients. The arbitrator's failure to disclose this information warranted vacatur of the award. *Benjamin, Weill & Mazer v. Kors*, 189 Cal. App.4th 126 (1st Dist. 2010). *Click here for full article*.

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  Fannie Mae has filed suit against a number of insurance companies seeking coverage under primary and excess financial institution bonds for losses resulting from a $131 million fraud perpetrated by US Mortgage Corporation. *Federal National Mortgage Assoc. v. Certain Underwriters at Lloyd's London*, Case 1:10-cv-01775 (D.D.C. filed Oct. 20, 2010) (amended complaint filed Nov. 12, 2010). *Click here for full article*.

Successor Liability Alert:
Fifth Circuit Strictly Enforces Non-Assignment Clause, Rejecting Transfer of Insurance Coverage

Reversing a lower court, the Fifth Circuit ruled that an asset purchase agreement did not transfer insurance coverage under a general liability policy to the purchasing company where that policy contained a non-assignment provision and the asset purchase agreement expressly excluded insurance policies from transfer. *Keller Foundations, Inc. v. Wausau Underwriters Ins. Co.*, 2010 WL 4673026 (5th Cir. Nov. 19, 2010).

Wausau provided Old Suncoast with general liability coverage. The policy included a non-assignment clause, which provided that the rights and duties under the policy could not be transferred without Wausau's consent. Old Suncoast entered into an agreement with Keller Foundation under which Keller agreed to purchase certain assets and assume certain liabilities from Suncoast. However, the purchase agreement excluded from transfer "all insurance policies" except certain employee benefit plans. After the sale, several lawsuits were filed, alleging property damage caused by Old Suncoast. The suits were based on Old Suncoast's work prior to the purchase agreement, and during the term of Wausau's policy. Keller assumed the defense of these suits pursuant to its assumption of liabilities in the purchase agreement. When Keller notified Wausau of the suits, Wausau denied coverage.

The Fifth Circuit agreed with Wausau that "the non-assignment clause bars any assignment of the coverage without Wausau's approval, rendering invalid any transfer that might have taken place." Under Texas law, non-assignment clauses are strictly enforced, even where coverage is sought for pre-acquisition losses, the court held. In so ruling, the court rejected Keller's attempt to "circumvent the non-assignment clause by casting the transfer of the insurance coverage as the transfer of a 'chose in action.'" It is unreasonable to differentiate between the assignment of interests in the policy as opposed to the assignment of fully-matured claims covered by the policy, the court explained. Likewise, the court rejected the argument that an insurer must show prejudice in order to enforce the non-assignment clause. Finally, the court rejected the district court's finding that Wausau's policy transferred "by operation of law" when Keller acquired the assets of Old Suncoast. Where, as here, the liabilities were assumed pursuant to a contract which expressly excluded the transfer of the insurance policy covering those liabilities, it would be unreasonable to allow transfer pursuant to an "operation of law" theory, the court explained.

Keller Foundations illustrates the strict enforcement of non-assignment clauses under Texas law, at least where the asset purchase agreement expressly excludes insurance policies from transfer. Although other jurisdictions have ruled that non-assignment provisions preclude only the transfer of coverage for

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post-assignment losses, Texas law has not endorsed this interpretation. Furthermore, although a number of courts, including the Ninth Circuit applying California law, have employed an "operation of law" theory in a successor liability case, the Fifth Circuit squarely rejected this doctrine as applied to the present case, in which the successor corporation assumed the acquired company's liabilities by contract.

D&O Alert:

First Circuit Rules that "Bump Up" Clause Bars Coverage for Certain Settlement Payments

Reversing in part a Massachusetts district court, the First Circuit ruled that a "bump up" clause in a directors and officers insurance policy barred coverage for settlement monies paid to resolve claims against Genzyme Corp. *Genzyme Corp. v. Federal Ins. Co.*, 622 F.3d 62 (1st Cir. 2010). The clause did not, however, preclude coverage for settlement amounts paid pursuant to the indemnification of individual directors and officers.

Genzyme sought to recover the costs it spent settling a shareholder class action which was based on a share exchange initiated by Genzyme. The settlement resolved all claims against both Genzyme and its directors and officers. Federal Insurance denied coverage for the settlement, arguing that the payment was not an "insurable loss" under the policy. As a preliminary matter, the First Circuit rejected the lower court's ruling that the settlement payments were uninsurable as a matter of public policy. The First Circuit disagreed with the district court's suggestion that allowing a company to "divide the benefits of equity ownership among its shareholders one way, redistribute those benefits, then demand indemnification from its insurer for the redivision" runs afoul of public policy. Turning to the applicable policy language, the First Circuit concluded that the "bump up" clause barred recovery for any payments made in the settlement of claims against Genzyme. The "bump up" clause excluded coverage for "the actual or proposed payment by any Insured Organization of allegedly inadequate or excessive consideration in connection with its purchase of securities issued by [Genzyme]." Although the stock exchange at issue was not technically a "purchase," both the allegations in the complaint and the language of Genzyme's own Articles of Organization revealed that the parties considered the transaction to be a purchase. This interpretation, the court explained, comported with the intent of the clause, which is to exclude claims alleging that company has favored one class of shareholders over another.

The court reached a different conclusion with respect to the claims against the directors and officers. Because the "bump up" exclusion explicitly referred only to the insuring clause which provides coverage for the company, and not to the insuring clause which provides coverage for payments made by the company to indemnify directors and officers, the exclusion did not operate to bar coverage for claims against the individuals.

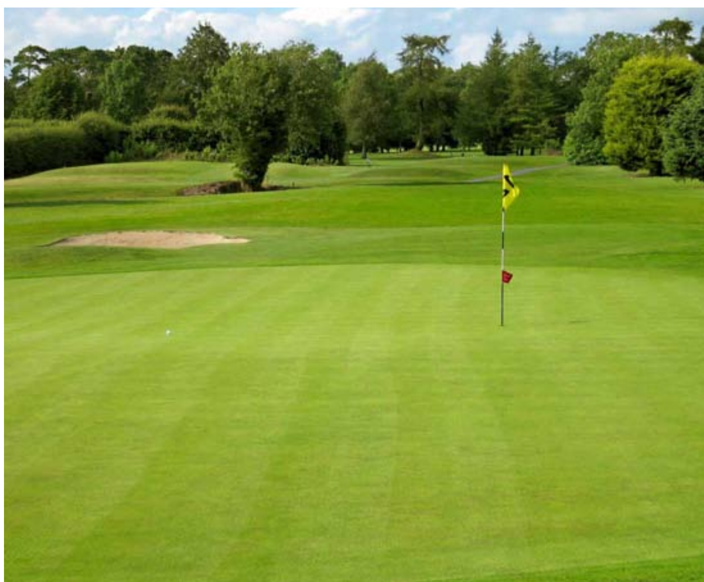
Genzyme makes clear that it is not against public policy (under Massachusetts law) to insure settlements based on a company's redistribution of equity ownership among shareholders. However, companies or directors setting shareholders claims should be mindful of "bump up" clauses in their policies.

Pollution Exclusion Alerts:

Florida Court Rules that Pollution Exclusion Bars Coverage for Negligent Hiring Claims

Enforcing an unambiguous pollution exclusion, a federal court in Florida ruled that a general liability insurer had no duty to defend or indemnify a lawsuit alleging claims of negligent hiring and supervision. *Nationwide Mut. Ins. Co. v. Lang Mgmt., Inc.*, 2010 WL 3958654 (S.D. Fla. Oct. 7, 2010).

The insured, Lang Management Company, hired a sub-contractor to perform maintenance of a golf course. The sub-contractor allegedly contaminated the golf course with a toxic herbicide, resulting in property damage and the loss of membership at the golf club. The suit against Lang asserted a breach of its duty to hire and supervise a competent maintenance company. Lang filed a declaratory judgment action against Nationwide, seeking to enforce Nationwide's defense and indemnity obligations. Nationwide denied coverage, arguing that the pollution exclusion negated all obligations under the policy. The court agreed. Property damage to the golf course, caused by "the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of 'pollutants'" is unambiguously barred by the exclusion. Additionally, the claims for lost membership fees are losses "arising out of" the effects of pollutants. Broadly interpreting the phrase "arising out of," the court reasoned that the negligent hiring and supervision claims were causally related to the effects of the herbicide on the golf course. As such, the pollution exclusion barred coverage for these claims as well.



Lang illustrates that a pollution exclusion may negate an insurer's duty to defend and indemnify even where the underlying complaint asserts causes of action which are not directly or traditionally associated with the environmental pollution. Numerous courts have likewise applied the pollution exclusion broadly to bar coverage in a variety of contexts. *See National Union Fire Ins. Co. v. U.S. Liquids, Inc.*, 88 Fed. Appx. 725 (5th Cir. 2004) (complaint alleging fraud, breach of fiduciary duty and securities violations is barred by pollution exclusion where claims arose, in part, from the insured's illegal waste dumping); *Danis v. Great American Ins. Co.*, 823 N.E.2d 59 (Ohio App. 2004) (pollution exclusion applies to business tort allegations against directors and officers because such allegations were intertwined with pollution activities); *James River Ins. Co. v. Ground Down Engineering, Inc.*, 540 F.3d 1270 (11th Cir. 2008) (pollution exclusion bars coverage by professional liability insurer in negligence action where claims "arise out of" pollution).

Tenth Circuit Affirms that Dirt and Rock are Pollutants Within Meaning of Exclusion

The Tenth Circuit affirmed that a general liability insurer had no duty to defend or indemnify its insured against claims alleging property damage caused by dirt, rock and soil. While these materials might not be considered traditional "pollutants," their deposit into a river, in violation of the Clean Water Act and a Colorado state statute, fell within the scope of a total pollution exclusion. Accordingly, the insurer had no duty to defend. *New Salida Ditch Co., Inc. v. United Fire & Cas. Ins. Co.*, 2010 WL 4250004 (10th Cir. Oct. 28, 2010).

The pollution exclusion at issue defined "pollutants" as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste." *New Salida Ditch Co., Inc. v. United Fire & Cas. Ins. Co.*, 2009 WL 5126498, at *6 (D. Colo. Dec. 18, 2009). The district court reasoned that the introduction of these materials into the pure waters of the Arkansas River constituted an act of contamination, thereby triggering the pollution exclusion. In a summary opinion, the Tenth Circuit affirmed. As of the date of this publication, the

policyholder's petition for an en banc rehearing, filed on November 11, 2010, remains pending.

Although interesting in its own right, *New Salida Ditch* is also significant in that the court's analysis focused not on the absolute nature of a substance as a "pollutant" (a position advocated by the policyholder), but rather on whether the substance at issue operated as a pollutant under the specific circumstances presented. While this conceptual distinction has been recognized by other courts in pollution exclusion disputes, some courts appear more reluctant to engage in this type of situation-specific analysis, and instead have relied on the notion that the term "pollutant" has a traditional, commonly understood meaning.

Professional Services Alert:
Law Firm's Unwitting Participation in Check Passing Scheme Does Not Constitute "Professional Services"

A federal court in South Carolina ruled that actions taken by a law firm at the direction of a "client" (who was, in actuality, orchestrating a check passing scheme) do not constitute professional services covered by the law firm's professional liability insurer. *Bradford & Bradford, P.A. v. Attorneys Liab. Protection Soc., Inc.*, 2010 WL 4225907 (D.S.C. Oct. 20, 2010).

The law firm received an email from an entity seeking the law firm's representation and assistance with collection efforts. The law firm emailed the client an engagement letter and a request for a $2,500 retainer. The client signed and returned the engagement letter via email. On the same day, the client informed the law firm that one of its customers was willing to make partial payment through the law firm. The law firm instructed the client that the customer should make its check payable to the firm. Shortly thereafter, the law firm received what appeared to be a Citibank check from the customer in the amount of $362,400.25 made payable to the law firm. At the direction of the client, the law firm deposited the check into its trust account and deducted $2,500 for the retainer. After it appeared that the funds from the check had posted and were available, the law firm wired portions of the $362,400.25 check to the "client's" accounts in Japan. Soon after the wire transfer transactions, the bank discovered that the $362,400.25 check was counterfeit. But by this time, the funds from the transfers had been removed from the Japanese bank accounts. The bank sued the law firm, seeking damages in the amount of the counterfeit check plus costs and attorneys' fees.

The law firm's professional liability insurer denied coverage, asserting that the bank's claims were outside the scope of coverage because they did not arise out of "professional services" provided by the law firm. The policy defined professional services as "services or activities performed for others as an attorney in an attorney-client relationship on behalf of one or more clients." Under this definition, in order for the law firm's actions to qualify as "professional services," an attorney-client relationship must have existed. Here, the bogus client had never intended to employ the law firm professionally; rather, the client's sole intention vis-à-vis the law firm was to perpetrate a fraud. This fact, the court concluded, defeated coverage under the policy. It mattered not that the parties had executed an engagement letter, or that the law firm had operated under the assumption that it was providing genuine legal services. An attorney-client relationship is based the mutual intent of the parties. The court noted that although the denial of coverage here may seem "harsh," courts in other jurisdictions have similarly "rejected as a matter of law the notion that facilitating a check-passing scheme on behalf of someone posing as a client constituted professional services by the lawyers involved."

Bradford makes clear that an attorney/policyholder's subjective and good faith belief that it is engaging in "professional services" may not be enough to trigger professional liability insurance coverage where the policyholder's conduct does not otherwise meet the objective criteria set forth in the relevant "professional services" insurance provision.

Discovery Alert:

Ninth Circuit Limits Supreme Court's Ruling Prohibiting Immediate Appeals of Certain Discovery Orders

In our January 2010 Alert, we noted that under the United States Supreme Court's decision in *Mohawk Indus., Inc. v. Carpenter*, 130 S. Ct. 599 (2009), disclosure orders adverse to the attorney-client privilege do not qualify for immediate appeal under the collateral order doctrine. In a recent decision, the Ninth Circuit ruled that *Mohawk* does not preclude the immediate appeal of a discovery order directed at "a disinterested third-party custodian of privileged documents." *United States v. Krane*, 2010 WL 4260978 (9th Cir. Oct. 29, 2010).

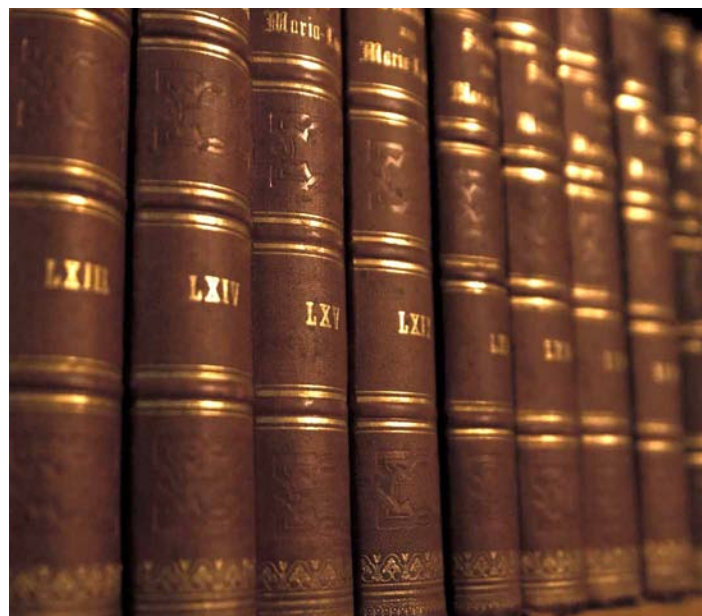
In *Krane*, two executives of the Quellos Group, LLC were charged in a criminal case. In connection with these charges, the government issued a *subpoena duces tecum* to Skadden, Arps, Slate, Meagher & Flom LLP, Quellos's former counsel. Although Quellos was not charged in the criminal case, the company intervened in the matter and asserted attorney-client privilege with respect to the materials sought by the government. The district court granted the government's motion to compel and Quellos filed an appeal.

Allowing the immediate appeal, the Ninth Circuit reasoned that where, as here, the privilege-holder is a disinterested third party (i.e., a party lacking a stake in the proceeding), such third parties may be more likely to simply produce the potentially privileged documents rather than engage in discovery-related litigation or expose themselves to a potential contempt citation. Furthermore, because neither Quellos (the privilege-holder) nor Skadden Arps (the custodian of the documents) were parties to the criminal proceedings, this case presents the unusual situation in which an interlocutory appeal would be the privilege-holder's "only opportunity to seek review of the district court's order adverse to its claim of attorney-client privilege." Whether the United States Supreme Court would agree with this reasoning is uncertain, and an appeal may be unlikely given the Ninth Circuit's ultimate dismissal of the appeal in *Krane* on the ground that there was no longer a justiciable controversy at issue.

Reinsurance Arbitration Alert:

Third Circuit Affirms Order Vacating Arbitration Award in Reinsurance Dispute on the Basis that Arbitration Panel Exceeded its Authority

On November 8, 2010, the Third Circuit affirmed a Pennsylvania district court's vacatur of an arbitration award on the ground that the arbitrators exceeded their powers under the Federal Arbitration Act. *PMA Capital Ins. Co. v Platinum Underwriters Bermuda, Ltd.*, 2010 WL 4409655 (3d Cir. Nov. 8, 2010). The reinsurance dispute centered on interpretation of a "deficit carry forward" provision in the policy, which entitled Platinum (the reinsurer) to seek reimbursement for losses carried from one year to the next. Following an arbitration hearing, the panel issued a one-page



award which (1) ordered PMA (the cedent) to pay Platinum $6 million, and (2) eliminated the "deficit carry forward" provision of the contract. The panel offered no reasoning for its decision.

Applying a "highly deferential" standard of review, the Third Circuit nonetheless held that the award exceeded the arbitrators' powers. The award could not be derived from either the reinsurance agreement or the parties' submissions. In particular, the relief awarded was not sought by either party and directly contravened the intent of the reinsurance contract by eliminating the "deficit carry forward" provision. As such, the award was "completely irrational" and subject to judicial revision. The court explained that although an honorable engagement clause permits arbitrators to stray from judicial formalities and from the contract's literal language in order to reasonably effectuate the contract's general intent, it does not give the arbitrators authority to re-write the contract which they are charged with interpreting.

PMA Capital serves as a reminder that while arbitrators' authority is expansive, it is not unlimited. Although other factual scenarios might present a closer call, the Third Circuit here had little trouble finding that an arbitration panel's *sua sponte* elimination of a material provision in a reinsurance contract, without explanation, exceeded the limits of an arbitrator's authority.

Arbitration Alerts:

Arbitrator's Failure to Disclose the Nature of His Legal Practice Requires Vacatur of Arbitration Award

A California Court of Appeal ruled that an arbitrator presiding over an attorneys' fee dispute should have revealed that the focus of his legal practice was the representation of lawyers engaged in fee disputes with former clients. The arbitrator's failure to disclose this information warranted vacatur of the award, the court held. *Benjamin, Weill & Mazer v. Kors*, 189 Cal. App.4th 126 (1st Dist. 2010).

The arbitration at issue arose out of a fee dispute between a client and the law firm she retained to represent her in a litigation matter. After a hearing, the panel issued an award of approximately $100,000 in favor of the law firm. The client moved to vacate the award, based primarily on the chief arbitrator's failure to disclose his "active and pervasive representation of law firms in [fee] disputes against clients," including specifically, his representation during the course of the subject arbitration of a prominent law firm in a fee dispute before the California Supreme Court. Rejecting the client's arguments, the trial court issued a ruling confirming the award. The appellate court reversed.

The California Arbitration Act requires the timely disclosure of "all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed neutral arbitrator would be able to be impartial." As a preliminary matter, the court rejected the law firm's argument that because the list of enumerated circumstances requiring disclosure (set forth in the Act) does not include the nature of an arbitrator's legal practice, there is no statutory duty to disclose such information. Rather, the phrase "all matters" illustrates Legislature's intent to require disclosure of *any* issue that might bear on the appearance of partiality, even if not specifically enumerated. The court reasoned that the arbitrator's dependence on business from law firms sued by former clients could cause a person to doubt his ability to rule in favor of a client in such a dispute.

Benjamin, Weill is noteworthy in several respects. First, the decision reinforces that arbitrator disqualification depends not on the presence or absence of actual bias, but rather upon the perception of bias. The limited question under the California Arbitration Act is whether the facts not disclosed "*could cause a person aware of the facts to reasonably entertain a doubt*" as to the arbitrator's impartiality. Second, *Benjamin, Weill* serves as a tempered warning to arbitrators: while

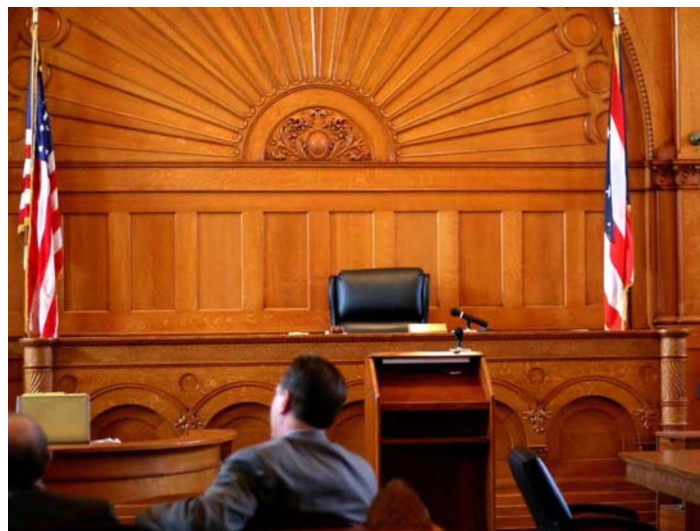
"ordinary and insubstantial business dealings" do not necessarily require disclosure, if such relationships are "substantial and creat[e] an impression of possible bias, they must be disclosed." Finally, the decision highlights the fundamental distinction between arbitrator disqualification and judicial recusal. California precedent generally equates the two, holding that there is "no reason to interpret the appearance-of-partiality rule more broadly in the context of arbitrator disclosure than in the context of judicial recusal." However, in the present case, the court found the difference between the judicial process and private arbitration to be critical. Whereas the award issued by the arbitrator here could have financial consequences (in terms of both the arbitrator's legal practice and the likelihood of being selected as an arbitrator in future disputes), a ruling by a judicial officer would implicate no such concerns. These economic considerations, the court held, could not be ignored. Thus, while the facts presented might fall short of the standard for judicial recusal, they justify disqualification in the arbitral arena.

Forum Selection Clause Requires that Arbitration of Claims and Arbitration of Counterclaims Be Held in Two Different Countries, Says Ninth Circuit

The Ninth Circuit ruled that a forum selection clause specifying arbitration at "the site of the defending party's" place of business requires that counterclaims be litigated at the counterclaim-defendant's place of business even if that is in a different country than where the principal claims are being arbitrated. *Polimaster Ltd. v. RAE Systems, Inc.*, 632 F.3d 832 (9th Cir. 2010). The court explained that the assertion of counterclaims transforms a plaintiff into a defendant for counterclaim purposes. Therefore, counterclaims must be arbitrated in the "defending party's" (i.e., the original plaintiff's) place of business.

The arbitrator had reasoned that it would be unfair and uneconomical to prosecute a claim with affirmative defenses in one venue, while simultaneously prosecuting counterclaims almost identical to the affirmative defenses in another venue. The arbitrator had therefore allowed all claims to be heard in California, the principal place of business of the original defendant. The district court confirmed the arbitrator's award. On appeal, the Ninth Circuit vacated the award, finding that the counterclaims should not have been arbitrated in California. The forum selection clause was unambiguous, the Ninth Circuit held. It required that "all requests for affirmative relief, whether styled as claims or counterclaims, be arbitrated at the defendant's site." Despite the inefficiencies created by this application, the court refused to override the explicit terms of the agreement. The court stated: "There is no sound basis for imputing a concern for efficiency to the parties in this case. We cannot assume that the parties' agreement to arbitrate was motivated by a desire for efficiency alone, or even that efficiency was a central motivation for their arbitration agreement. … Non-efficiency justifications for arbitration are especially important in the realm of international contracting."

The arbitration agreement in *Polimaster* was unusual in that it did not specify a choice of law or procedural rules, nor did it provide for the number of arbitrators or a method of appointment. Given that the agreement was clear in at least one respect—its choice



of forum—the court seemed particularly intent on enforcing this provision. Other courts have similarly enforced forum selection clauses strictly, even where such enforcement results in piecemeal litigation. In any event, *Polimaster* illustrates the necessity of careful and precise drafting in arbitration forum selection clauses, particularly in cases involving international disputes, in which the public policy of efficiency might not be paramount.

Life Insurance Alert:

New York's Highest Court Sanctions Stranger-Owned Life Insurance Transactions

On November 17, 2010, the New York Court of Appeals ruled that "New York law permits a person to procure an insurance policy on his or her own life and immediately transfer it to one without an insurable interest in that life, even where the policy was obtained for just such a purpose." *Kramer v. Phoenix Life Ins. Co.*, 2010 WL 4628103 (N.Y. Nov. 17, 2010). The central issue before the court was interpretation of New York Insurance Law §3205, which governs the purchase and transfer of life insurance policies. Section 3205(b)(2) explicitly prohibits procurement of a life insurance contract on the life of another by a person with no insurable interest in the life of the named insured. "Insurable interest" is defined as "in the case of persons closely related by blood or by law, a substantial interest engendered by love and affection" or, for others, a "lawful and substantial economic interest in the continue life, health or bodily safety of the person insured." However, there is no such "insurable interest" requirement when a life insurance policy is purchased by the named insured his/herself. Further, Section 3205(b)(1) explicitly permits the insured to immediately transfer or assign such an insurance contract.

The court's decision, grounded in the statutory language, acknowledges the tension between "the law's distaste for wager policies and its sanctioning of an insured's procurement of a policy on his or her own life for the purpose of selling it." Nonetheless, absent a legislative directive precluding the latter, the court declined to judicially impose such a prohibition.

Litigation Alert:

Fannie Mae Turns to Insurers for Losses Arising from US Mortgage Scam

Fannie Mae has filed suit against a number of insurance companies seeking coverage under primary and excess financial institution bonds for losses resulting from a $131 million fraud perpetrated by US Mortgage Corporation. *Federal National Mortgage Assoc. v. Certain Underwriters at Lloyd's London*, Case 1:10-cv-01775 (D.D.C. filed Oct. 20, 2010) (amended complaint filed Nov. 12, 2010). In the complaint, Fannie Mae asserts that the bond program covers losses "resulting directly from Fannie Mae having in good faith and in the ordinary course of business purchased mortgage loans which proved to be based upon stolen original mortgages." According to the complaint, Fannie Mae's insurers have denied coverage for these losses, contending that a loss under the bonds requires a "physical taking," rather than a fraudulent assignment. The action seeks a declaratory judgment that the loss suffered by Fannie Mae as a result of the US Mortgage fraud is covered under the bonds. Additionally Fannie Mae seeks damages for breach of contract and breach of the implied covenant of good faith and fair dealing. We will continue to monitor this litigation, and any others that follow in this context.

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

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"'I would take all my essential litigation to them,' raves a client"

—Benchmark Litigation 2010

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