Simpson Thacher

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In This Issue

Applying English Law, Second Circuit Rules That Reinsurer's Obligations Are Co-extensive With Cedent's Obligations Under Umbrella Policy

Affirming a New York district court decision, the Second Circuit ruled that a facultative reinsurer's indemnity obligations were co-extensive with the obligations of the underlying policy. *Ins. Co. of the State of Pa. v. Equitas Ins. Ltd.*, 2023 U.S. App. LEXIS 12461 (2d Cir. May 22, 2023). (Click here for full article)

Seventh Circuit Rules That "Catch-All" Provision In Violation-Of-Statutes Exclusion Is Ambiguous

The Seventh Circuit ruled that a policy exclusion was ambiguous and therefore that an insurer was obligated to defend a suit against an insured alleging violations of Illinois' Biometric Information Privacy Act. *Citizens Ins. Co. of Am. v. Wynndalco Enters., LLC*, 2023 U.S. App. LEXIS 14834 (7th Cir. June 15, 2023). (Click here for full article)

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Reversing District Court, Third Circuit Rules That Insurer Owes No Coverage For Fracking-Related Damage Claims

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First Circuit Grants Motion To Compel Arbitration Notwithstanding State Law Prohibiting Arbitration Of Insurance Disputes

The First Circuit ruled that a Puerto Rico law that prohibits mandatory arbitration of insurance disputes does not reverse-preempt the Convention on the Recognition and Enforcement of Foreign Arbitral Awards and therefore granted the insurer's motion to compel arbitration. *Green Enters., LLC v. Hiscox Syndicates Ltd.*, 2023 U.S. App. LEXIS 12421 (1st Cir. May 19, 2023). (Click here for full article)

Third Circuit Says That Pennsylvania Law Does Not Recognize Exceptions To "Four Corners" Rule For Duty To Defend

The Third Circuit declined to determine whether, under Pennsylvania law, an insurer in a dispute over a duty to defend can introduce extrinsic evidence relevant to a dispositive coverage issue when that issue is unrelated to the merits of the underlying liability case. The court observed that Pennsylvania follows the "four corners" rule and has not yet recognized any exceptions to that approach. *Republic Franklin Ins. Co. v. Ebensburg Ins. Agency*, 2023 U.S. App. LEXIS 14528 (3d Cir. June 9, 2023). (Click here for full article)

Applying English Law, Second Circuit Rules That Reinsurer's Obligations Are Co-extensive With Cedent's Obligations Under Umbrella Policy

HOLDING

Affirming a New York district court decision, the Second Circuit ruled that a facultative reinsurer's indemnity obligations were co-extensive with the obligations of the underlying policy. *Ins. Co. of the State of Pa. v. Equitas Ins. Ltd.*, 2023 U.S. App. LEXIS 12461 (2d Cir. May 22, 2023).

BACKGROUND

Homeowners in California sued Dole Food Company ("Dole") for alleged pollution of soil and groundwater that spanned more than four decades. Dole and its insurer, the Insurance Company of the State of Pennsylvania ("ICSOP"), settled the claims and allocated $20 million of the settlement payment to a three-year ICSOP policy in effect from 1968-1971. In so allocating the settlement, Dole and ICSOP applied California's "all sums" approach to allocation; under this approach, ICSOP was jointly and severally liable (up to applicable policy limits) for all property damages and personal injuries caused by a pollutant, without regard to ICSOP's time on the risk compared to other Dole insurers. ICSOP then sought coverage from Equitas Insurance Limited ("Equitas") under a facultative reinsurance policy in effect during the same three-year period.

Equitas denied the claim on the ground that the law governing the parties' reinsurance policy did not recognize "all sums" allocation. ICSOP sued, and the parties cross-moved for summary judgment. The district court granted ICSOP's summary judgment motion and found Equitas liable to ICSOP for the full $20 million payment. The Second Circuit affirmed.

DECISION

Equitas asked the court to distinguish between ICSOP's liability *to Dole* (which Equitas conceded) and Equitas's liability *to ICSOP* under the reinsurance agreement. Equitas argued that it had no liability to ICSOP because the parties' reinsurance agreement was governed by English law and English law does not follow the "all sums" approach to allocation. Because ICSOP's obligation to Dole arose from an "all sums" allocation, Equitas argued that no coverage applied under the reinsurance agreement. For its part, ICSOP argued that, under English law, the reinsurance agreement provided co-extensive coverage with ICSOP's policy issued to Dole.

The Second Circuit favored ICSOP's position. As the court framed the issue, "the question is whether, once ICSOP's liability was properly allocated, as Equitas concedes that it was, English law would then interpret the reinsurance policy as providing co-extensive coverage." Answering this question in the affirmative, the Second Circuit held that English law has a "strong presumption" that facultative reinsurance policies provide "back-to-back" coverage with the cedent's underlying policy, "meaning that the liability of the insured is generally equivalent to the liability of the reinsured." In so ruling, the court rejected Equitas's assertion that English law would not apply that presumption where, as here, a foreign jurisdiction's law results in coverage for damage beyond the policy's coverage period.

The Second Circuit also rejected Equitas's contention that, because California's "all sums" rule did not come into existence until long after the parties had executed the umbrella and reinsurance policies at issue, English law would not impose an "all sums" approach in the present case. Although it acknowledged that the argument had "some merit," the court ultimately concluded that when parties fail to define contract terms such as "all sums," they necessarily "adopt the meaning a common law court will ascribe to it, and thereby bear the rewards and risks of the common law's dynamic nature." Thus, Equitas could not "confine its current obligations to what those obligations would have been had this dispute arisen fifty years ago."

COMMENTS

In decisions governed by the law of U.S. jurisdictions, the presence or absence of a follow-the-settlements clause can be outcome-determinative in terms of a reinsurer's obligations to indemnify an underlying settlement that has been allocated to a reinsured policy. Here, while the reinsurance policy did include such a clause, the Second Circuit's decision was driven largely by the presumption of co-extensive coverage for facultative reinsurance agreements under English precedent rather than the text of the particular contract provision.

Seventh Circuit Rules That "Catch-All" Provision In Violation-Of-Statutes Exclusion Is Ambiguous

HOLDING

The Seventh Circuit ruled that a policy exclusion was ambiguous and therefore that an insurer was obligated to defend a suit against an insured alleging violations of Illinois' Biometric Information Privacy Act ("BIPA"). *Citizens Ins. Co. of Am. v. Wynndalco Enters., LLC*, 2023 U.S. App. LEXIS 14834 (7th Cir. June 15, 2023).

BACKGROUND

The coverage dispute arose out of two putative class action lawsuits initiated against Wynndalco Enterprises, LLC ("Wynndalco"), alleging BIPA violations. Citizens Insurance Company of America ("Citizens") sought a declaration that it had no duty to defend or indemnify Wynndalco based on a violation-of-statutes exclusion. The exclusion, entitled "Distribution of Material in Violation of Statutes," encompassed bodily injury and property damage arising out of four specified statutes: the Telephone Consumer Protection Act (the "TCPA"), the CAN-SPAM Act of 2003, the Fair Credit Reporting Act, and the Fair and Accurate Credit Transaction Act. The exclusion also contained a "catch-all" provision that applied to "[a]ny other laws, statutes, ordinances, or regulations, that address, prohibit or limit the printing, dissemination, disposal, collecting, recording, sending, transmitting, communicating or distribution of material or information." The Illinois district court held that the catch-all provision was facially ambiguous and therefore unenforceable. As a result, the court granted Wynndalco's motion for judgment on the pleadings. The district court reasoned that "a literal reading of the expansive wording of that provision would preclude coverage not only for violations of privacy-related statutes like BIPA, but a number of other statutory causes of action that the policy in the first instance purported to cover, including slander, libel, trademark, and copyright." The Seventh Circuit affirmed.

DECISION

The Seventh Circuit acknowledged that "[t]here is no dispute that a literal, plain-text reading of the catch-all provision would include BIPA violations." Nonetheless, the court concluded that the provision was ambiguous because a liberal and broad reading of it would exclude from coverage injuries or damage arising from a large category of claims (including intellectual property claims, in particular) that the policy by its express terms otherwise purported to cover.

Citizens argued that the catch-all provision in the exclusion was not overbroad because it applied only to privacy-related statutory claims, as indicated by the four privacy-related statutes specified in the exclusion immediately prior to the catch-all provision. Rejecting this contention, the Seventh Circuit noted that neither the title of the exclusion nor the catch-all provision evidenced an intention to limit its application to privacy-related statutory claims. While the interpretative canon of *ejusdem generis* holds that broad or general contract terms are construed according to the specific terms that precede them, the court held that this interpretative canon did not resolve the ambiguity in this case because there was no "readily discernible theme" among the four specified statutes in the exclusion that "points to privacy as the focus of the exclusion."

COMMENTS

Illinois courts are divided on the proper application of similar catch-all provisions in violation-of-statues exclusions; some have concluded that such provisions apply squarely to BIPA claims, while others have deemed them ambiguous. As discussed in our May 2021 Alert, the Illinois Supreme Court ruled that an insurer was obligated to defend a suit alleging BIPA violations, finding that a violation-of-statutes exclusion did not apply. *West Bend Mut. Ins. Co. v. Krishna Schaumburg Tan, Inc.*, 2021 Ill. LEXIS 430 (Ill. May 20, 2021). In that case, the exclusion specifically referenced only two statutes, the TCPA and the CAN-SPAM Act of 2003, and it also included a "catch-all" provision that applied to "any statute, ordinance or regulation" that prohibits or limits the distribution of material or information. The Illinois Supreme Court, applying the interpretative canon of *ejusdem generis*, reasoned that the catch-all provision applied only to statutes that regulate methods of communication (such as telephone calls, emails, or faxes) and therefore did not extend to BIPA, which regulates the collection of personal data.

In *Wynndalco*, the Seventh Circuit distinguished *Krishna Schaumburg*, explaining that the exclusion in that case presented a clear theme relating to claims involving methods of communication, which allowed the *Krishna Schaumburg* court to limit the catch-all provision in a reasonable way, whereas the exclusion at issue in *Wynndalco* failed to establish a cohesive or clear theme relating to privacy claims. It is notable that, in making this distinction, the Seventh Circuit focused on the title of the exclusion in each case as a relevant factor, emphasizing the absence of the word "privacy" in the title of the exclusion in *Wynndalco*. In a footnote, the Seventh Circuit acknowledged that the title of an exclusion plays only a limited role in its construction, but noted that titles "are permissible indicators of the meaning of the text that follows them."

Reversing District Court, Third Circuit Rules That Insurer Owes No Coverage For Fracking-Related Damage Claims

HOLDING

The Third Circuit ruled that an insurer had no duty to indemnify its insured against property damage claims arising out of the insured's own faulty workmanship in connection with fracking activities, finding that the claims did not arise out of a covered "occurrence" and that a policy endorsement providing "equipment coverage" did not eliminate the "occurrence" requirement. *Am. Home Assurance Co. v. Superior Well Services, Inc.*, 2023 U.S. App. LEXIS 13355 (3d Cir. May 31, 2023).

BACKGROUND

U.S. Energy Development Corporation ("U.S. Energy") contracted with Superior Well Services, Inc. ("Superior") for hydraulic fracking services to extract natural gas from wells owned by U.S. Energy. When certain wells incurred damage, U.S. Energy filed suit. American Home Assurance Company ("American Home") defended Superior under a reservation of rights. A jury found in favor of U.S. Energy, returning a special verdict that Superior "fail[ed] to perform its contract . . . in a workman like manner." Thereafter, American Home sought a declaration that its general liability policy did not cover the underlying claims based on the absence of an "occurrence." U.S. Energy intervened as a defendant and, in response to American Home's argument, argued that an "underground resources and equipment coverage" endorsement—which encompassed property damage to "[a]ny well, hole, formation . . . [or] [a]ny casing, pipe, bit, tool, pump or other drilling or well servicing machinery or equipment"—provided coverage. A Pennsylvania district court awarded summary judgment to Superior (and, by extension, U.S. Energy), ruling that the endorsement encompassed the fracking operations and provided coverage regardless of whether Superior's faulty workmanship constituted a covered "occurrence." The Third Circuit reversed.

DECISION

As a preliminary matter, the Third Circuit ruled that the property damage at issue was not caused by an "occurrence" because, under established Pennsylvania precedent, faulty workmanship is not an accident or an unexpected and unintended event. Turning to the question of whether the endorsement superseded the "occurrence" requirement, the Third Circuit held that it did not. The court explained that an endorsement might supersede a policy provision if the two clauses were in conflict, but that no such conflict existed here. The endorsement defined "underground resources and equipment hazard" to include property damage to oil and gas wells, among other property, and therefore incorporated the "occurrence" requirement via the "property damage" requirement.

COMMENTS

In coverage disputes, policyholders often argue that endorsements displace original policy provisions that operate to limit coverage. The Third Circuit's opinion clarifies that, unless an endorsement directly conflicts with a coverage provision, the former should not be construed to displace the requirements set forth in the latter. This decision suggests that, in order for an endorsement to trump a core policy requirement, clear language to that effect may be required.

First Circuit Grants Motion To Compel Arbitration Notwithstanding State Law Prohibiting Arbitration Of Insurance Disputes

HOLDING

The First Circuit ruled that a Puerto Rico law that prohibits mandatory arbitration of insurance disputes does not reverse-preempt the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "Convention") and therefore granted the insurer's motion to compel arbitration. *Green Enters., LLC v. Hiscox Syndicates Ltd.*, 2023 U.S. App. LEXIS 12421 (1st Cir. May 19, 2023).

BACKGROUND

Green Enterprises, LLC ("Green"), a Puerto Rican recycling company, sought coverage from its insurer following a fire at one of its plants. When the insurer denied coverage, Green filed suit. The insurer moved to compel arbitration pursuant to an arbitration clause in the insurance policy. A Puerto Rico district court granted the motion, and the First Circuit affirmed.

DECISION

The central question before the First Circuit was whether the Puerto Rico statute prohibiting mandatory arbitration of insurance disputes reverse-preempted the Convention under the McCarran-Ferguson Act, which provides that "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." The issue before the court turned on whether the Convention was a "self-executing" treaty: if the Convention constituted a "self-executing treaty," it would not require an "Act of Congress" to be effectuated as domestic law, and it would therefore not be subject to reverse-preemption under the McCarran-Ferguson Act.

The First Circuit concluded that the provision of the Convention that states that courts "shall" refer parties to arbitration was self-executing and did not require an "Act of Congress" to be enforceable as domestic law. Therefore, the court held that there was no reverse-preemption and that the arbitration clause must be enforced pursuant to the Convention.

COMMENTS

The First Circuit's decision is noteworthy in several respects. First, the court held that a treaty can have both self-executing and non-self-executing provisions. The decision therefore leaves open the possibility that a different provision of the Convention is not self-executing and might thus be subject to reverse-preemption by a state law. Second, the decision signals a growing consensus among federal circuit courts on this issue. While the Second Circuit has ruled that the Convention is not self-executing and therefore that state law prohibiting arbitration of insurance disputes reverse-preempts the Convention, the Fourth, Fifth, and Ninth Circuits have reached contrary conclusions. Notably, the Ninth Circuit expressly ruled on the "self-executing" issue, whereas the Fourth and Fifth Circuits did not reach that issue and instead held that, regardless of whether the Convention is self-executing, the McCarran-Ferguson Act does not apply to international treaties and instead limits reverse-preemption to the domestic Federal Arbitration Act.

Third Circuit Says That Pennsylvania Law Does Not Recognize Exceptions To "Four Corners" Rule For Duty To Defend

HOLDING

The Third Circuit declined to determine whether, under Pennsylvania law, an insurer in a dispute over a duty to defend can introduce extrinsic evidence relevant to a dispositive coverage issue when that issue is unrelated to the merits of the underlying liability case. The court observed that Pennsylvania follows the "four corners" rule and has not yet recognized any exceptions to that approach. *Republic Franklin Ins. Co. v. Ebensburg Ins. Agency*, 2023 U.S. App. LEXIS 14528 (3d Cir. June 9, 2023).

BACKGROUND

An insurance agency sought coverage from Republic Franklin Insurance Company ("Republic"), its professional liability insurer, for a suit alleging professional negligence and fraudulent misrepresentation, among other claims. Republic defended under a reservation of rights, but later sought a declaration that it had no duty to defend. Republic argued that its policy did not provide coverage for the underlying claims because the insurance agency had knowledge of a wrongful act that was likely to give rise to a claim prior to the policy's inception. In support of this contention, Republic relied on certain deposition testimony and a reservation of rights letter related to separate litigation, both of which purportedly established the insurance agency's knowledge of wrongful acts likely to give rise to a claim prior to the policy's effective date. A Pennsylvania district court dismissed Republic's suit, ruling that consideration of extrinsic evidence was impermissible under Pennsylvania law. The Third Circuit affirmed.

DECISION

The Third Circuit explained that, under Pennsylvania's "four corners" approach, an insurer's duty to defend is determined by comparing the allegations in the underlying complaint to the insurance contract. In seeking to rely on certain extrinsic evidence in its declaratory judgment action, Republic noted that the Pennsylvania Supreme Court has acknowledged that, "to the extent there are undetermined facts that might impact on coverage, the insurer has a duty to defend until the 'claim is narrowed to one patently outside the policy coverage.'" Republic argued that this statement means that, once an insurer's duty to defend is triggered, an insurer may offer evidence outside the complaint to negate its duty to defend, so long as the coverage issue is independent of the underlying claims. The Third Circuit viewed this contention with some skepticism, but declined to decide the question. The Third Circuit noted that the Pennsylvania Supreme Court's holding could mean that a narrowing of the duty to defend could occur if the underlying plaintiff drops or the court dismisses the claims that had triggered policy coverage.

The Third Circuit ruled in favor of the policyholder on the ground that Republic could not prove, while the underlying merits action was pending, that an exclusion concerning known wrongful acts applied. That exclusion precluded coverage for claims arising out of known wrongful acts. The Third Circuit found that whether such a wrongful act occurred was the subject of the underlying merits litigation and adjudication of the issue would "overlap with the issues" in that case. Extrinsic evidence related to the underlying merits question would not be considered under Pennsylvania law.

COMMENTS

The Third Circuit seemed to acknowledge that consideration of extrinsic evidence might be appropriate in some duty to defend disputes, including disputes over a policyholder's failure to establish a "condition precedent" to coverage (such as the requirement of when a claim was "first made"). The Third Circuit noted that a Pennsylvania trial court considered extrinsic evidence relating to a condition precedent to coverage in determining an insurer's duty to defend, but distinguished that decision from the present case, in which the insurer sought to rely on extrinsic evidence for purposes of enforcing a policy exclusion. Additionally, as the Third Circuit noted, other jurisdictions, such as Florida and Texas, expressly recognize limited exceptions to the "four corners" rule.

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