Simpson Thacher

Insurance Law Alert

October 2014

This Alert addresses recent decisions relating to late notice, pre-notice expenses, and whether a non-signatory may be equitably bound by an arbitration clause. In addition, we report on two recent pollution exclusion rulings and interpretation of an "insured v. insured" exclusion. Finally, we discuss decisions relating to voluntary payments, broker liability and unsettled questions of policy interpretation under Georgia law.

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–Legal 500 US 2014

Third Circuit Rules That Non-Signatory Is Not Equitably Bound to Arbitrate Insurance Dispute

The Third Circuit ruled that a non-signatory to an arbitration agreement was not equitably estopped from refusing to arbitrate. *Flintkote Co. v. Aviva PLC*, 2014 WL 5033218 (3d Cir. Oct. 9, 2014). (click here for full article)

Costs Are "Incurred" at Time of Settlement, Not When Approved by a Regulatory Agency, Says Indiana Court of Appeals

The Indiana Court of Appeals ruled that Travelers is not liable for expenses arising from a pre-notice settlement, even though regulators approved of the settlement after notice had been given to Travelers. *Travelers Cas. & Sur. Co. of Am. v. Maplehurst Farms, Inc.*, 2014 WL 4851663 (Ind. Ct. App. Sept. 30, 2014). (click here for full article)

Second Circuit Court Declines to Extend Reach of Statutory Notice-Prejudice Requirement

The Second Circuit ruled that an insurer has no duty to indemnify pollution-related claims due to the policyholder's late notice, regardless of prejudice to the insurer. *Indian Harbor Ins. Co. v. City of San Diego*, 2014 WL 4922143 (2d Cir. Oct. 2, 2014) (Summary Order).
(click here for full article)

Nebraska Supreme Court Rules That Pollution Exclusion Encompasses Lead Paint Claims

The Nebraska Supreme Court ruled that lead paint claims are barred by a pollution exclusion as a matter of law, regardless of the manner of exposure to the underlying claimant. *State Farm Fire & Casualty Co. v. Dantzler*, 289 Neb. 1, 852 N.W.2d 918 (2014).
(click here for full article)

Tenth Circuit Rejects Argument That Absolute Pollution Exclusions Are Ambiguous As Overbroad

Applying Utah law, the Tenth Circuit ruled that several variations of absolute pollution exclusions in general liability policies were unambiguous and barred coverage for damage and injury allegedly caused by fly ash contamination. *Headwaters Resources, Inc. v. Illinois Union Ins. Co.*, 2014 WL 5315090 (10th Cir. Oct. 20, 2014). (click here for full article)

California Court Deems "Insured v. Insured" Exclusion Ambiguous in Context of FDIC Receivership Claims

A California federal district court ruled that an insured v. insured exclusion was ambiguous as to whether it applied to claims brought by the FDIC in a receiver capacity. *St. Paul Mercury Ins. Co. v. Hahn*, 2014 WL 5369400 (C.D. Cal. Oct. 8, 2014). (click here for full article)

Policyholder's Payment Is Not "Voluntary" If Mandated by Statute, Says Pennsylvania Court

A Pennsylvania federal district court ruled that a policyholder did not violate a voluntary payments provision by making payments that were required by statute. *First Commonwealth Bank v. St. Paul Mercury Ins. Co.*, 2014 WL 4978383 (W.D. Pa. Oct. 6, 2014).
(click here for full article)

Eleventh Circuit Certifies Coverage Questions to Georgia Supreme Court

The Eleventh Circuit asked the Georgia Supreme Court to address important coverage issues relating to interpretation of a "consent-to-settle" provision and interpretation of the policy phrase "legally obligated to pay." *Piedmont Office Realty Trust, Inc. v. XL Specialty Ins. Co.*, 2014 WL 5334551 (11th Cir. Oct. 21, 2014). (click here for full article)

Sixth Circuit Rules That Broker Had No Duty to Provide Coverage Advice to Policyholder

The Sixth Circuit concluded as a matter of law that a broker had no duty to recommend particular insurance to its client. *Hardy Oil Co., Inc. v. Nationwide Fargo Ins.-Indiana*, 2014 WL 4693816 (6th Cir. Sept. 22, 2014). (click here for full article)

STB News

Click here for information Simpson Thacher's involvement in insurance-related events and honors. (click here for full article)

Arbitration Alert:

Third Circuit Rules That Non-Signatory Is Not Equitably Bound to Arbitrate Insurance Dispute

Reversing a Delaware federal district court decision, the Third Circuit ruled that a non-signatory to an arbitration agreement was not equitably estopped from refusing to arbitrate. *Flintkote Co. v. Aviva PLC*, 2014 WL 5033218 (3d Cir. Oct. 9, 2014).

In 1985, Flintkote, an asbestos supplier, reached a settlement of asbestos-related claims with several London insurers via the Wellington Agreement, which required disputes to be resolved through mediation and arbitration. One insurer, Aviva, did not participate in the Wellington Agreement and instead entered into a separate agreement with Flintkote, which reserved each party's right to litigate disputes. In 2006, after filing for bankruptcy, Flintkote initiated mediation with its London insurers. Aviva participated in the mediation proceedings, sharing joint representation with the other insurers. The mediation agreement did not reference the Wellington Agreement. In 2012, Aviva moved in Delaware bankruptcy court to lift the automatic stay that had been imposed under federal bankruptcy law in order to pursue a declaratory judgment action against Flintkote. Flintkote, in turn, moved to compel Aviva to arbitrate. A Delaware district court granted Flintkote's motion, ruling that although Aviva was not a signatory to the Wellington Agreement, it was equitably estopped from avoiding arbitration by virtue of its ongoing participation in the mediation process. The Third Circuit reversed.

The Third Circuit ruled that Flintkote had not established equitable estoppel by clear and convincing evidence, as required by Delaware law. The Third Circuit rejected the two bases upon which the district court had found equitable estoppel: (1) that Aviva knowingly "embraced" the Wellington Agreement to obtain benefits to which it otherwise would not have been entitled, and (2) that Flintkote detrimentally relied on Aviva's participation in mediation. The Third Circuit explained that Aviva had never signed the Wellington Agreement or otherwise forfeited its litigation rights. Furthermore, the court held that a single reference to the Wellington Agreement in a letter sent by the insurers' counsel during mediation did not establish that Aviva "embraced" or directly benefitted from the Wellington Agreement. Rather, the court noted that a "single invocation" of the Wellington Agreement over the course of several years "falls well short of 'consistently' seeking the benefit of 'other provisions of the same contract.'" Similarly, the Third Circuit ruled that Flintkote could not have reasonably relied on Aviva's participation in mediation as an assurance that Aviva had consented to arbitration. Any such reliance was not reasonable, the court explained, in light of the litigation provision in the Flintkote-Aviva settlement agreement and the absence of any references to the Wellington Agreement in the mediation agreement.

As discussed in prior Simpson Thacher Insurance Alerts (*e.g.*, July/August 2014 and July/August 2013), other courts have similarly denied petitions to compel non-signatories to arbitrate where the factual record does not sufficiently establish equitable estoppel or other doctrines that would warrant enforcement of an arbitration clause (*e.g.*, assumption, assignment or incorporation by reference).

Voluntary Payments Alert:

Costs Are "Incurred" at Time of Settlement, Not When Approved by a Regulatory Agency, Says Indiana Court of Appeals

The Indiana Court of Appeals ruled that Travelers is not liable for expenses arising from a pre-notice settlement, even though regulators approved of the settlement after notice had been given to Travelers and despite the fact that certain costs were incurred after the notice. *Travelers Cas. & Sur. Co. of Am. v. Maplehurst Farms, Inc.*, 2014 WL 4851663 (Ind. Ct. App. Sept. 30, 2014).

The coverage dispute arose out of contamination at a dairy farm owned by Maplehurst. In 2002, the Indiana Department of Environmental Management ("IDEM") advised Maplehurst to provide a remediation plan. Maplehurst submitted a corrective action plan ("CAP") to IDEM and reached a settlement agreement with the subsequent

owner of the dairy farm under which it assumed full responsibility for remediation. Thereafter, Maplehurst discovered insurance policies for the relevant time period and in 2003, provided notice of the claim to the insurers, including Travelers. The insurers denied coverage for Maplehurst's pre-notice costs. In ensuing litigation, the Indiana Court of Appeals ruled that Travelers was not responsible for Maplehurst's pre-notice expenses, reasoning that an insurer's duties do not arise until an insurer is provided with notice of the claim. However, the appellate court noted that "Travelers remains liable for the costs and expenses … that Maplehurst incurred after it notified Travelers of the claim." On remand, Maplehurst sought recoupment of its costs, arguing that as final approval of a revised CAP was not given by the IDEM until 2004, related costs should be considered to have been incurred after notice was given to Travelers. The trial court agreed. The appellate court reversed.

The appellate court concluded that Maplehurst had incurred the expenses in question in 2002, when it submitted the original CAP to IDEM and reached a settlement with the subsequent property owner—both of which occurred prior to giving notice to Travelers. The court reasoned that expenses are deemed "incurred" when Maplehurst obligated itself to remediate the property, not when IDEM approved the final CAP. "The final CAP merely described how Maplehurst would be required to remediate the property; Maplehurst agreed in the [settlement] to remediate to IDEM's standards long before Travelers was notified of the claim." The court reached this conclusion notwithstanding that some of the remediation occurred after notice to Travelers, explaining that all of the post-notice costs flowed from the pre-notice settlement.

Late Notice Alert:

Second Circuit Court Declines to Extend Reach of Statutory Notice-Prejudice Requirement

Affirming a New York federal district court decision, the Second Circuit ruled that an insurer has no duty to indemnify pollution-related claims due to the policyholder's late notice, regardless of whether the insurer was prejudiced by the late notice. *Indian Harbor Ins. Co. v. City of San Diego*, 2014 WL 4922143 (2d Cir. Oct. 2, 2014) (Summary Order).

In 2009, New York statutory law was amended to prevent liability insurers from denying coverage on policies "issued or delivered" in New York after January 17, 2009 on the basis of late notice absent a showing of prejudice. N.Y. Ins. Law § 3420(a)(5). Prior to the amendment, New York common law did not require a showing of prejudice.

Indian Harbor argued that it had no duty to indemnify pollution claims because the policyholder had waited 58 days before providing notice and because the policy was not "issued or delivered" in New York. The district court agreed and granted Indian Harbor's summary judgment motion. The Second Circuit affirmed, ruling that Section 3420 was inapplicable and that notice was untimely as a matter of law.

In reaching its decision, the Second Circuit concluded that the policy was not "issued" in New York. The policyholder argued that because Indian Harbor's president, whose signature was on the policy, had his office in New York, the policy should be deemed issued in New York. The court explained that the president's signature was a pre-existing electronic signature and was, in any event, affixed to the policy in Pennsylvania. Additionally, the policy was created in and mailed from Pennsylvania and all correspondence bore the Pennsylvania office's letterhead.

The court also rejected the notion that Section 3240 created a new public policy and thus abrogated New York's common law no-prejudice rule, noting that had the "legislature intended to change the common law for all policies, it could have done so." As discussed in our June 2014 Alert, other courts have similarly declined to apply Section 3240 where the criteria set forth therein are not met. *See KeySpan Gas East Corp. v. Munich Reinsurance American, Inc.*, 2014 WL 2573382 (N.Y. June 10, 2014) (heightened standard for late notice disclaimer set forth in Section 3420 does not apply to environmental property damage claims). Finally, the court ruled that the 58 day delay was unreasonable as a matter of law, noting that similar length delays are routinely deemed unreasonable under New York law.

Pollution Exclusion Alerts:

Nebraska Supreme Court Rules That Pollution Exclusion Encompasses Lead Paint Claims

Reversing an intermediate appellate court, the Nebraska Supreme Court ruled that lead paint claims are barred by a pollution exclusion as a matter of law, regardless of the manner of exposure to the underlying claimant. *State Farm Fire & Casualty Co. v. Dantzler*, 289 Neb. 1, 852 N.W.2d 918 (2014).

State Farm sought a declaration that a pollution exclusion precluded coverage for injuries allegedly sustained by a tenant as a result of exposure to lead paint. A Nebraska trial court granted State Farm's summary judgment motion, but the intermediate appellate court reversed. The appellate court agreed with the trial court that lead paint constituted a pollutant, but ruled that a material question of fact existed as to whether the exposure occurred through a "discharge, dispersal, spill, release or escape," as specified in the exclusion. The Nebraska Supreme Court reversed, ruling that the pollution exclusion barred coverage as a matter of law because the terms "discharge, dispersal, spill, release or escape" encompass all possible movements by which exposure to lead could occur.

This *Dantzler* case broadly holds that under Nebraska law, a pollution exclusion bars coverage for lead paint claims regardless of (1) whether exposure occurred via inhalation or ingestion, (2) whether the claimant was exposed to paint chips, flakes, dust or fumes, or (3) whether the lead paint separated from the painted surface by flaking over the passage of time or by intentional chewing on an intact painted surface. The court reasoned that the terms "discharge, dispersal, spill, release or escape" encompass the separation of lead-based paint that is inherent in every case of lead paint poisoning. Therefore, "a determination of the specific process of exposure in any particular case is not material to application of the exclusion." In so ruling, the court expressly distinguished and rejected Connecticut case law (*see Danbury Ins. Co. v. Novella*, 727 A.2d 279 (Conn. 1998)), on which the appellate court had relied. Instead, the court found persuasive the reasoning

of numerous other courts that have applied pollution exclusions to preclude coverage for lead paint claims, including a Delaware trial court decision discussed in our November 2013 Alert (*see Farm Family Casualty Co. v. Cumberland Ins. Co., Inc.*, 2013 WL 5496780 (Del. Super. Ct. Oct. 2, 2013)).

Tenth Circuit Rejects Argument That Absolute Pollution Exclusions Are Ambiguous As Overbroad

Applying Utah law, the Tenth Circuit ruled that several variations of absolute pollution exclusions in general liability policies were unambiguous and barred coverage for damage and injury allegedly caused by fly ash contamination. *Headwaters Resources, Inc. v. Illinois Union Ins. Co.*, 2014 WL 5315090 (10th Cir. Oct. 20, 2014).

The policyholder sought coverage for costs arising from two suits alleging that its construction of a golf course resulted in personal injury and property damage caused by the dispersal of fly ash. The liability insurers denied coverage on the basis of the policies' pollution exclusions. The insurers moved for summary judgment, which a Utah district court granted. The district court ruled that for some policies (which excluded coverage for "actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of 'pollutants'" when combined with one of five enumerated circumstances), the pollution exclusion unambiguously barred coverage. On other policies with similar, but not identical, pollution exclusion language (which excluded coverage for "any injury, damage, expense, cost, loss, claims, liability or legal obligation arising out of or in any way related to pollution, however caused"), the district court declined to rule on whether the exclusions were ambiguous and instead held that regardless of any potential ambiguity, the exclusions applied to the claims in the underlying complaints. The Tenth Circuit affirmed, concluding that all pollution exclusions were unambiguous as a matter of law and clearly encompassed the underlying claims.

The Tenth Circuit rejected the policyholder's argument that "the comprehensiveness of the pollution exclusions reveals ambiguity within the policies because literal application of the exclusions abolishes coverage." Acknowledging that the pollution exclusions were "far-reaching," the court nonetheless held that they were unambiguous and enforceable. In so ruling, the Tenth Circuit rejected an argument frequently asserted by policyholders in this context—that a pollution exclusion is overbroad where it bars coverage for events arising from the policyholder's regular business activities.

The court expressly noted that there is some disagreement between courts nationwide in this area. While a few courts, including a Utah federal district court, have ruled that a broad exclusion that encompasses "normal business activities" creates ambiguity, the Tenth Circuit disagreed.

D&O Alert:

California Court Deems "Insured v. Insured" Exclusion Ambiguous in Context of FDIC Receivership Claims

Our April 2014 Alert discussed a First Circuit decision requiring an insurer to advance defense costs under a directors and officers policy due to uncertainty as to whether an "insured v. insured" exclusion barred coverage for claims brought by the Federal Deposit Insurance Corporation ("FDIC"). In a ruling issued this month, a California federal district court reached the same conclusion, finding that the exclusion was ambiguous as to whether it applied to claims brought by the FDIC in a receiver capacity. *St. Paul Mercury Ins. Co. v. Hahn*, 2014 WL 5369400 (C.D. Cal. Oct. 8, 2014).

The FDIC, acting as appointed receiver for a defunct bank, sued the bank's former directors and officers for negligence and breach of fiduciary duty. Travelers, the bank's D&O insurer, filed a declaratory judgment action seeking a ruling that its policy did not cover the underlying claims. In particular, Travelers relied on the "insured v. insured" exclusion, which barred coverage for any claim "brought or maintained by or on behalf of any Insured or Company [including the Bank] in any capacity." Travelers argued that because the FDIC "stands in the shoes" of the bank and brought claims "on behalf of" the bank, the exclusion applied. The court disagreed and granted the FDIC's summary judgment motion.

The court held that the phrase "on behalf of" is ambiguous when applied to the FDIC. Rather than basing ambiguity on the policy language, the court reasoned that the presence of conflicting case law across jurisdictions on this issue renders the exclusion ambiguous. Having deemed the exclusion ambiguous, the court resolved the issue against the insurer. Noting that the policy could have expressly specified that the exclusion applied to claims brought by the FDIC, the court emphasized an insurer's obligation to "phrase exceptions and exclusions in clear and unmistakable language."

Voluntary Payments Alert:

Policyholder's Payment Is Not "Voluntary" If Mandated by Statute, Says Pennsylvania Court

A Pennsylvania federal district court denied an insurer's motion to dismiss a breach of contract action, ruling that the policyholder did not violate a voluntary payments provision by making payments that were required by statute. *First Commonwealth Bank v. St. Paul Mercury Ins. Co.*, 2014 WL 4978383 (W.D. Pa. Oct. 6, 2014).

As a result of computer malware, funds from a client's bank account were transferred to unauthorized parties. In response to the client's demands, the bank agreed to refund

the transferred amounts. Thereafter, the bank notified its insurer of the loss and sought to recover its payments. The insurer denied coverage, arguing that it had no duty to indemnify because the bank breached the voluntary payments provision, which stated that the "Insurer shall not be liable for any settlement, Defense Costs, assumed obligation, admitted liability, voluntary payment, or confessed or agreed Damages or judgment to which it has not consented." The court disagreed.

The court denied the insurer's motion to dismiss, finding that the bank had a valid breach of contract claim against its insurer. The court reasoned that the bank's payments were not "voluntary" because they were required by state statutory law (relating to refunds of unauthorized wire transfers). The court held that a payment is not voluntary when it is "compelled by law or other outside influences." The court rejected the insurer's argument that the payment was voluntary because the bank could have refused to pay and tendered the claim to the insurer.

Policyholders may seek to rely on *First Commonwealth Bank* more broadly, such as in contamination cases in which payments are made pursuant to local or federal environmental statutes without insurer consent, particularly given the court's reliance on *Federal Ins. Co. v. Purex Indus., Inc.*, 972 F. Supp. 872 (D.N.J. 1997), which held that a mandatory payment under the Environmental Cleanup Responsibility Act did not violate a voluntary payments provision. In this context, *First Commonwealth Bank* may give rise to disputes relating to whether a statutory payment should be deemed voluntary or mandatory.

Policy Interpretation Alert:

Eleventh Circuit Certifies Coverage Questions to Georgia Supreme Court

Citing to a lack of state law precedent, the Eleventh Circuit asked the Georgia Supreme Court to address two issues: (1) whether an insured is "legally obligated to pay" a claim if it voluntarily settles an underlying suit but that settlement is approved and authorized by a final court order, and (2) whether a court may bar coverage based on a policyholder's violation of a "consent-to-settle" clause without first deciding whether the insurer unreasonably withheld consent. *Piedmont Office Realty Trust, Inc. v. XL Specialty Ins. Co.*, 2014 WL 5334551 (11th Cir. Oct. 21, 2014).

Piedmont Office Realty Trust purchased a primary policy that provided up to $10 million in coverage and an excess policy that provided an additional $10 million in coverage. Piedmont was named as a defendant in a class action securities suit seeking $150 million in damages. After protracted litigation of the securities claims, a court dismissed the action. The class action plaintiffs appealed. Piedmont had already exhausted its primary policy limit and had used $4 million of its excess coverage. While the appeal was pending, Piedmont engaged in mediation with the class. Piedmont sought the excess insurer's consent to settle the suit for up to the remaining limits of the excess

policy. The excess insurer agreed only to contribute an addition $1 million. Despite the excess insurer's position (and without further notice to the excess insurer), Piedmont settled the underlying suit for $4.9 million. A court approved the settlement and entered a final judgment and order implementing the terms of the agreement. Thereafter, Piedmont sued the excess insurer.

A Georgia district court granted the insurer's motion to dismiss. The district court reasoned that because Piedmont had voluntarily settled the underlying case, it was not "legally obligated to pay" the securities claim as required by the excess policy. The district court also ruled that Piedmont violated the policy's "consent-to-settle" provision by settling the underlying case with the insurer's consent.

On appeal, the Eleventh Circuit found that "substantial doubt" existed as to whether, under Georgia law, the "legally obligated to pay" requirement may be satisfied by a voluntary settlement if a final court order exists that directs implementation of the settlement. The Eleventh Circuit also sought guidance from the Georgia Supreme Court as to whether a court can deny coverage based on a policyholder's violation of a "consent-to-settle" clause (which provides that the insurer's consent "shall not be unreasonably withheld") without first determining whether the insurer's withholding of consent was unreasonable. We will keep you updated on developments in this matter.

Broker Alert:

Sixth Circuit Rules That Broker Had No Duty to Provide Coverage Advice to Policyholder

Our March 2014 Alert discussed a New York Court of Appeals decision holding that a question of fact existed as to whether an insurance broker owed a duty to provide coverage advice to its client. *See Voss v. Netherlands Ins. Co.*, 2014 WL 804129 (N.Y. Feb. 25, 2014). There, the court held that although a broker is generally not obligated to provide coverage advice, a duty may be created by the parties' course of dealing over an extended period of time—an issue that the court held required factual resolution. The Sixth Circuit recently addressed the same issue and applied the same legal standard for broker liability, but concluded as a matter of law that a broker had no duty to recommend particular insurance to its client. *Hardy Oil Co., Inc. v. Nationwide Fargo Ins.-Indiana*, 2014 WL 4693816 (6th Cir. Sept. 22, 2014).

In *Hardy Oil*, the court held that a broker's duty to provide coverage advice arises under three circumstances: (1) when the client pays consideration beyond the premium; (2) when the parties' extended course of dealing would put an objectively reasonable broker on notice that his advice is being relied upon; or (3) when the client makes a specific request for advice. The client argued that the second circumstance—his long-term relationship with the broker and the broker's knowledge of his petroleum business—gave rise to the broker's special duties. The court rejected this argument, finding that the parties' extended relationship was not based on reliance on the broker's expertise, but rather on the favorable price of the broker's services. Therefore, the Sixth Circuit affirmed the district court decision granting the broker's summary judgment motion.

STB News Alert

Simpson Thacher's Insurance Practice was ranked as Tier 1 by Euromoney's Benchmark Litigation 2015. The publication described Simpson Thacher as "revered by peers and clients for [its] all-around litigation practice … and its oft-heralded insurance practice." Partners Barry Ostrager, Mary Kay Vyskocil, Andrew Amer, Mary Beth Forshaw and Bryce Friedman were named Local Litigation Stars (New York) and Litigation Stars - U.S., Insurance.

Last month, Thomson Reuters announced the publication of the Third Edition of Modern Reinsurance Law and Practice, authored by Barry R. Ostrager and Mary Kay Vyskocil. The treatise discusses thousands of reinsurance-related decisions and provides a comprehensive analysis of numerous issues central to reinsurance litigation.

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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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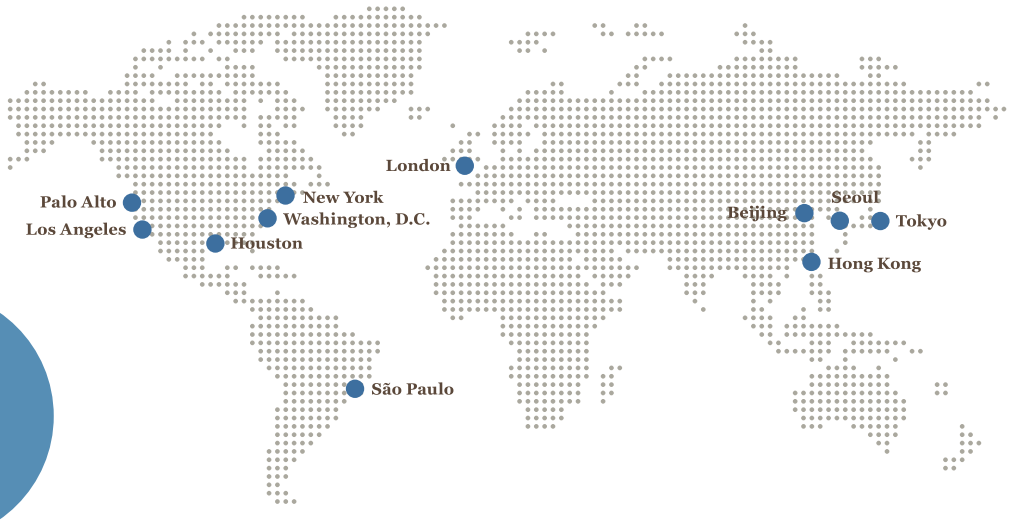

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