SIMPSON THACHER

INSURANCE LAW ALERT

DECEMBER 2011

This Alert addresses two important asbestos-related decisions—one rejecting a policyholder's attempt to access "non-products" coverage, and the other leaving open the possibility of the appointment of a receiver for a dissolved company in order to allow asbestos claimants to access insurance proceeds. We also address decisions relating to the scope of "advertising injury" and "additional insured" coverage and the meaning of the term "occurrence" in the context of faulty workmanship claims. In addition, this Alert discusses recent opinions on late notice and a policyholder's obligation to tender defense of a claim to its insurer. Finally, we highlight significant rulings in the bankruptcy and arbitration contexts, some of which involve splits of authority among federal circuit courts. Please "click through" to view articles of interest. Happy Holidays!

- ***Sixth Circuit Affirms Dismissal of Claims Involving Novel Theories of Asbestos Liability Coverage***

  The Sixth Circuit affirmed the dismissal of claims against a number of insurers, including one of Simpson Thacher's insurance clients, resolving a dispute involving a new theory of "non-products" asbestos liability coverage. *Bondex Int'l, Inc. v. Hartford Accident & Indem. Co.*, 2011 WL 5924556 (6th Cir. Nov. 28, 2011). *Click here for full article*

- ***Delaware Court Leaves Door Open for Appointment of Receiver for Dissolved Corporation Faced with Asbestos Liability***

  A Delaware Chancery Court refused to dismiss an action seeking appointment of a receiver for a defunct Delaware company that has been dissolved for more than a decade, reasoning that the asbestos claimants had alleged facts that conceivably could justify the appointment of a receiver. The court additionally held that service may be perfected on a dissolved corporation. *In the Matter of Krafft-Murphy*, 2011 WL 5420808 (Del. Ch. Ct. Nov. 9, 2011). *Click here for full article*

- ***Antitrust Claims Do Not Allege Covered Advertising Injury, Says Seventh Circuit***

  The Seventh Circuit affirmed an Indiana district court ruling that claims alleging price fixing in violation of the Sherman Act did not fall within the scope of "advertising injury" in a general liability policy, and thus that the insurers had no duty to defend. *Rose Acre Farms, Inc. v. Columbia Cas. Co.*, 2011 WL 5313818 (7th Cir. Nov. 1, 2011). *Click here for full article*

- ***Louisiana Court Limits Scope of "Additional Insured" Coverage under Policies Issued to Owner of Deepwater Horizon Oil Rig***

  A Louisiana federal district court held that various BP, Plc entities were not entitled to "additional insured" coverage under policies issued to Transocean Ltd, the owner of the Deepwater Horizon oil rig, because BP's drilling contract with Transocean explicitly provided that BP was responsible for pollution liabilities. *In re Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mex. on April 20, 2010*, 2011 WL 5547259 (E.D. La. Nov. 15, 2011). *Click here for full article*

- ***Tenth Circuit Rules That General Liability Policy May Provide Coverage for Unanticipated Damage Arising from Faulty Workmanship***

  The Tenth Circuit held that "because damage to property caused by poor workmanship is generally neither expected nor intended, it may qualify under Colorado law as an occurrence and liability coverage should apply." *Greystone Constr., Inc. v. Nat'l Fire & Marine Ins. Co.*, 2011 WL 5148688 (10th Cir. Nov. 1, 2011). *Click here for full article*

- ***Second Circuit Says That Three Month Delay in Forwarding Legal Papers Is Untimely as a Matter of Law***

  The Second Circuit affirmed a district court ruling that a policyholder failed to comply with an insurance policy's notice requirement by waiting approximately three months before sending the insurer copies of legal papers related to a pending lawsuit. *Rockland Exposition, Inc. v. Great Am. Assurance Co.*, 2011 WL 5176188 (2d Cir. Nov. 2, 2011). *Click here for full article*

- ***Policyholder's Failure to Tender Defense Relieves Insurer of Duty to Defend, Says Tennessee Court***

  A federal court in Tennessee dismissed a policyholder's breach of contract claim against its insurer, finding that because the policyholder failed to expressly tender the defense of any lawsuit to the insurer, the insurer had no duty to defend. *Travelers Indem. Co. v. W.M. Barr & Co.*, No. 2:08-CV-02649 (W.D. Tenn. Oct. 31, 2011). *Click here for full article*

- ***U.S. Supreme Court Rejects Challenge to Third Circuit Ruling Upholding Insurers' Bankruptcy Standing***

  The United States Supreme Court denied certiorari to debtor-in-possession Global Industrial Technologies, Inc., leaving undisturbed a Third Circuit ruling that insurers had standing to object to a plan of reorganization that relied on insurance policy proceeds to fund the payment of silica personal injury claims. *In re Global Indus. Techs., Inc.*, No. 11-280 (U.S. Nov. 7, 2011). *Click here for full article*

- ***Illinois Court Allows Insurer Discovery into Bankruptcy Trust's Claims Handling and Trust Disposition Procedures and Upholds Privilege Regarding Reinsurance Information***

  An Illinois court rejected an asbestos trust's claims of attorney-client privilege and work product protection for documents relating to claims handling, prepetition settlements, and trust distribution procedures. The court also held that an insurer does not waive privilege by sharing documents with a reinsurer if, as here, the two entities share a "common interest." *ARTRA 524(g) Asbestos Trust v. Transport Ins. Co.*, 2011 WL 4501375 (N.D. Ill. Sept. 28, 2011).
  Click here for full article

- ***Arkansas Supreme Court Rules That State Statute Prohibiting Arbitration of Insurance Disputes Trumps Federal Arbitration Act***

  The Arkansas Supreme Court refused to compel arbitration of a contract dispute, finding that state statutory law prohibiting arbitration in insurance disputes overrode the federal interest of enforcing arbitration clauses pursuant to the Federal Arbitration Act. *S. Pioneer Life Ins. Co. v. Thomas*, 2011 WL 5583912 (Ark. Nov. 17, 2011).
  Click here for full article

- ***Seventh Circuit Rules That District Court Erred in Vacating Arbitration Award on the Basis of Manifest Disregard of the Law***

  The Seventh Circuit held that a "manifest disregard of the law" is not a ground upon which a district court may vacate an arbitration award under the Federal Arbitration Act. *Affymax, Inc. v. Ortho-McNeil-Janssen Pharm., Inc.*, 2011 WL 4634222 (7th Cir. Oct. 3, 2011). *Click here for full article*

- ***Fifth Circuit Declines to Stay Proceedings Pending Appeal of Court's Denial of Motion to Compel Arbitration***

  The Fifth Circuit ruled that there is no automatic stay when a party appeals a district court's refusal to compel arbitration, and that under the circumstances presented, a discretionary stay was not warranted. *Weingarten Realty Investors v. Miller*, 2011 WL 5142183 (5th Cir. Nov. 1, 2011). *Click here for full article*

- ***STB News Alerts***

  Click here for announcements regarding on Simpson Thacher lawyers' involvement in insurance-related organizations and publications.

Asbestos Litigation Alerts:

Sixth Circuit Affirms Dismissal of Claims Involving Novel Theories of Asbestos Liability Coverage

A panel for the Sixth Circuit unanimously affirmed the dismissal of claims against a number of insurers, including one of Simpson Thacher's insurance clients, resolving a dispute involving what the court described as a "new theory" of asbestos liability coverage. *Bondex Int'l, Inc. v. Hartford Accident & Indem. Co.*, 2011 WL 5924556 (6th Cir. Nov. 28, 2011).

The litigation arose after RPM, Inc. and its affiliates exhausted the aggregate limits applicable to products liability claims under certain primary and excess general commercial liability policies. For decades, RPM and its insurers had treated claims related to products manufactured by the Reardon Company, whose assets and liabilities RPM acquired in 1966, as products hazard claims subject to an aggregate limit. However, after exhaustion of the aggregate limit, RPM argued that claims arising from Reardon's products had been "misclassified" and should not have been treated as products hazard claims (and therefore should not be subject to any aggregate limit). RMP argued that Reardon's products had not become RPM's products as a result of RPM's contractual assumption of Reardon's liabilities. RPM also argued that because Reardon's liabilities were assumed in an asset purchase, Reardon's liabilities should be governed by the policies' contractual liability coverage provisions.

The district court rejected RPM's arguments and granted summary judgment to defendant insurers. The Sixth Circuit affirmed on the basis of an analysis of who was a "Named Insured" at policy inception. Under the terms of the policies, the aggregate limit applied to any "Named Insured." The term "Named Insured" was defined to include "any subsidiary company" and

"any other company under [the policyholder's] control and active management." The court concluded that under this broad definition, Reardon was a "Named Insured" and thus claims arising from its products were subject to the policies' aggregate limit. In so ruling, the court noted that extrinsic evidence relating to general insurance industry developments was far less probative than the parties' actual course of performance, which strongly supported the insurers' coverage positions and "suggest[ed] that [RPM had] discovered a new *theory* for unlimited coverage in 2003, rather than a misclassification of [its] claims."

As aggregate limits on policies covering insureds with substantial asbestos exposure are exhausted, insureds often resort to litigating new theories to determine additional coverage. The Sixth Circuit in *Bondex* properly rejected such an attempt and confirmed that the product hazard should be construed in accord with its plain meaning, consistent with the underwriting intent and with applicable course of performance.

This edition of the Insurance Law Alert was prepared by Bryce L. Friedman (bfriedman @stblaw.com/212-455-2235) and Elisa Alcabes (ealcabes@stblaw.com/212- 455-3133).

Delaware Court Leaves Door Open for Appointment of Receiver for Dissolved Corporation Faced with Asbestos Liability

A Delaware Chancery Court refused to dismiss a petition seeking appointment of a receiver for a defunct Delaware company that has been dissolved for more than a decade, reasoning that the asbestos claimants had alleged facts that conceivably could justify the appointment of a receiver. The court additionally held that service may be perfected on a dissolved corporation. *In re Krafft-Murphy*, 2011 WL 5420808 (Del. Ch. Ct. Nov. 9, 2011).

Faced with hundreds of asbestos-related lawsuits, Krafft-Murphy Company, Inc. ceased operations in 1991 and was formally dissolved in 1999. However, the company continued to defend and settle asbestos claims under the direction of its insurers until 2009. After 2009, Krafft-Murphy refused to litigate new claims, which prompted the filing of this receivership action by asbestos claimants seeking the appointment of a receiver in order to enable them to access insurance proceeds. Krafft-Murphy, through its insurers, filed a motion to dismiss. The asbestos claimants filed a motion to perfect service. The court denied the insurers' motion and granted the claimants' motion.

Under Delaware law, the standard for surviving a motion to dismiss is reasonable "conceivability." The court held that Delaware statutory law permits the appointment of a receiver at any time following the dissolution of a company in order to "safeguard the collection and administration of still existing property interests of a dissolved corporation." A receiver may be appointed "to do all … acts which might be done by the corporation … that may be necessary for the final settlement of the unfinished business of the corporation." Del. Code tit. 8 § 279. The court concluded that claimants' petition sufficiently alleged the existence of "unfinished business" that, if proven, could necessitate the appointment of a receiver. The court also held that, despite its dissolution, service upon Krafft-Murphy could be perfected by newspaper publication pursuant to Del. Code tit. 10 § 3111(b).

It remains to be seen whether the asbestos claimants will ultimately be able to meet their burden of establishing the necessity of appointing a receiver in this case. That determination will likely depend, among other things, on an analysis of Delaware statutory law governing the dissolution of companies and the question of whether Krafft-Murphy's insurance policies constitute "still existing property interests" of the now defunct corporation.

Advertising Injury Alert:
Antitrust Claims Do Not Allege Covered Advertising Injury, Says Seventh Circuit

The Seventh Circuit affirmed an Indiana district court ruling that claims alleging price fixing in violation of the Sherman Act did not fall within the scope of "advertising injury" in a general liability policy. *Rose Acre Farms, Inc. v. Columbia Cas. Co.*, 2011 WL 5313818 (7th Cir. Nov. 1, 2011). Therefore, the insurers had no duty to defend.

The policyholder, an egg producer, was sued in several class action suits alleging a conspiracy to fix the price of eggs in violation of federal antitrust law. The policyholder tendered defense of the suits to its insurers under the advertising injury provision of the policies, which provided coverage for claims alleging misappropriation and other intellectual property-related torts. The insurers refused to defend. Applying Indiana law, the district court granted summary judgment to the insurers, and the Seventh Circuit affirmed. The court held that the class action complaints did not allege any facts that could fall within the scope of advertising injury—neither the policyholder's website nor any other advertising activities were at issue. In any event, the court noted that it would be unreasonable to interpret an advertising injury provision to indirectly

cover the "major business risk" of antitrust liability.

The Eleventh Circuit, construing the same policy definition of "advertising injury" and applying Florida law, also recently held that antitrust claims did not constitute "advertising injury," and thus that the insurer had no duty to defend. *Trailer Bridge, Inc. v. Ill. Nat'l Ins. Co.*, 657 F.3d 1135 (11th Cir. 2011).

Additional Insured Alert:

Louisiana Court Limits Scope of "Additional Insured" Coverage under Policies Issued to Owner of Deepwater Horizon Oil Rig

In the multidistrict litigation over the Deepwater Horizon oil spill, a Louisiana federal district court held that various BP, Plc entities were not entitled to "additional insured" coverage under policies issued to

Transocean Ltd, the owner of the Deepwater Horizon oil rig, because BP's drilling contract with Transocean explicitly provided that BP was responsible for subsurface pollution liabilities. *In re Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mex. on Apr. 20, 2010*, 2011 WL 5547259 (E.D. La. Nov. 15, 2011).

Transocean's primary and excess insurers filed a declaratory judgment action seeking a ruling that they were not obligated to indemnify BP for its pollution-related liabilities resulting from the Deepwater Horizon disaster. BP moved to dismiss the action, arguing that it was an "additional insured" under the policies at issue. The insurers countered that any "additional insured" coverage available to BP under Transocean's policies was limited to liabilities assumed by Transocean in the drilling contract between Transocean and BP. And because Transocean had not assumed oil pollution risks pertaining to the Deepwater Horizon incident (BP had assumed those risks), BP was not an additional insured as to those risks. The court agreed. Because BP had assumed responsibility for subsurface pollution-related liabilities in the drilling contract, the court concluded that there could be no "additional insured" coverage for BP under Transocean's policies for those liabilities.

Occurrence Alert:

Tenth Circuit Rules That General Liability Policy May Provide Coverage for Unanticipated Damage Arising from Faulty Workmanship

In previous Alerts, we have discussed the divide among courts as to whether, and under what circumstances, faulty workmanship constitutes an "occurrence" under a general liability policy. In a recent opinion, the Tenth Circuit held that "because damage to property caused by poor workmanship is generally neither expected nor intended, it may qualify under Colorado law as an occurrence and liability coverage should apply." *Greystone Constr., Inc. v. Nat'l Fire & Marine Ins. Co.*, 2011 WL 5148688 (10th Cir. Nov. 1, 2011).

The coverage dispute arose out of construction defect lawsuits brought against home builders. National Fire & Marine Insurance Company, a general liability insurer for one of the contractors, denied coverage on the basis that the underlying complaints did not allege accidents that would trigger its policies. The Colorado district court agreed with National Fire and granted

summary judgment in the insurer's favor. On appeal, the Tenth Circuit vacated the district court's opinion. As a preliminary matter, the Tenth Circuit held that a recently-enacted Colorado statute, which creates a presumption that faulty workmanship resulting in unexpected and unintended property damage is an accident under liability insurance policies issued to construction professionals, did not apply retroactively to the case at bar. *See* Colo. Rev. Stat. § 13-20-808. The court then addressed whether, under Colorado law, unforeseen property damage arising from faulty workmanship can constitute an "occurrence" under standard CGL policy language. The court held that it can—at least for purposes of evaluating an insurer's duty to defend. The court explained that although an "occurrence" generally requires an element of fortuity, an "occurrence" may also be established where an accident causes unanticipated or unforeseeable damage to otherwise non-defective property. The court noted, however, that certain policy exclusions (such as the "your work" or "business risk" exclusions) might ultimately bar coverage for faulty workmanship claims, and that the applicability of such exclusions must be evaluated on a case-by-case basis.

In another recent opinion, a federal court similarly found that claims of property damage caused by faulty workmanship constituted an "occurrence" under a general liability policy, but nonetheless granted summary judgment to the insurer on both the duty to defend and indemnify because a "your work" exclusion barred coverage. *Haskins Constr., Inc. v. Mid-Continent Cas. Co.*, 2011 WL 5325734 (D. Mont. Nov. 3, 2011).

Notice Alert:

Second Circuit Says That Three Month Delay in Forwarding Legal Papers Is Untimely as a Matter of Law

The Second Circuit affirmed a district court ruling that a policyholder failed to comply with an insurance policy's notice requirement by waiting approximately three months before sending the insurer copies of legal papers related to a pending lawsuit. *Rockland Exposition, Inc. v. Great Am. Assurance Co.*, 2011 WL 5176188 (2d Cir. Nov. 2, 2011). The insurance policy required the policyholder to "immediately" send to the insurer copies of legal documents received in connection with a claim or suit. The court explained that because periods of less than three months have been held unreasonable under New York law even under the less stringent "as soon as practicable" standard, such delay clearly violated the "immediate" requirement set forth in the policies at issue here. Although questions relating to the timeliness of notice are often questions of fact, the reasonableness of notice may be a question of law where, as here, facts relating to the delay are not in dispute and the policyholder has not offered a valid excuse for the delay.

The court reached its decision without regard to whether the insurer was prejudiced by the delay. Pursuant to revised New York statutory law, N.Y. Ins. Law § 3420(a)(5), under insurance policies issued after January 17, 2009, and subject to certain exceptions, claims may not be invalidated as untimely unless the failure to provide timely notice has prejudiced the insurer. The *Rockland Exposition* court was not bound by the statute because the insurance policy in that case had been issued prior to the statute's effective date.

Defense Alert:

Policyholder's Failure to Tender Defense Relieves Insurer of Duty to Defend, Says Tennessee Court

A federal court in Tennessee dismissed a policyholder's breach of contract claim against its insurer, finding that because the policyholder failed to expressly tender the defense of any lawsuit to the insurer, the insurer had no duty to defend. *Travelers Indem. Co. v. W.M. Barr & Co.*, No. 2:08-CV-02649 (W.D. Tenn. Oct. 31, 2011). W.M. Barr, the policyholder, had been sued in numerous actions alleging injury from benzene exposure. Steadfast Insurance Company and several other insurers had issued policies to Barr. Although Barr provided notice of all relevant lawsuits to Steadfast, it never invoked Steadfast's contractual obligation to defend or settle any lawsuit. Therefore, the court held, Steadfast had no duty to "step forward" and defend. Rather, "only the insurer the policyholder selects must defend … the various insurers will then apportion liability among themselves according to the 'other insurance' provisions in the relevant policies, or under the common law doctrine of equitable contribution."

Bankruptcy Alerts:

U.S. Supreme Court Rejects Challenge to Third Circuit Ruling Upholding Insurers' Bankruptcy Standing

The United States Supreme Court denied certiorari to debtor-in-possession Global Industrial Technologies, Inc. ("GIT"), leaving undisturbed a Third Circuit ruling upholding insurer standing in the bankruptcy context. *In re Global Indus. Techs., Inc.*, No. 11-280 (U.S. Nov. 7, 2011). The Third Circuit held that GIT's insurers had standing to object to a plan of reorganization that relied on insurance policy proceeds to fund the payment of GIT's silica personal injury claims. Pursuant to GIT's plan, two trusts were to be established to handle and pay GIT's personal injury liabilities—one for asbestos-related claims and a second for silica-related claims. Insurance was to fund both trusts. Certain insurers who had not reached settlements with GIT objected to the silica trust. The bankruptcy court confirmed GIT's plan, finding that GIT's insurers lacked standing to object because they suffered no injury as a result of the silica trust. The district court affirmed.

The Third Circuit reversed. In an *en banc* decision, the court found that GIT's insurers satisfied both Constitutional and statutory requirements for standing to object to plan confirmation. *In re Global Indus. Techs., Inc.*, 645 F.3d 201 (3d Cir. 2011). The court rejected GIT's contention that the plan was "insurance neutral" and observed that GIT's promise of a silica trust "appears to have staggeringly increased" the insurers' pre-petition liability exposure. The court also rejected arguments that the insurers' injuries were too speculative and noted that denying standing would be inappropriate in this case because of "nonfrivolous allegations of collusion between GIT and the asbestos claimants' counsel." Ultimately, the court held that "when a federal court gives its approval to a plan that allows a party to put its hands into other people's pockets, the ones with the pockets are entitled to be fully heard and to have their legitimate objections addressed."

The case has been remanded to the bankruptcy court, where GIT and the insurers have engaged in mediation. The impact of the Third Circuit's ruling on standing remains to be seen. However, the ruling supports insurers seeking to raise objections to bankruptcy plans that purport to alter or affect rights and obligations under their insurance contracts.

Illinois Court Allows Insurer Discovery into Bankruptcy Trust's Claims Handling and Trust Disposition Procedures and Upholds Privilege Regarding Reinsurance Information

In *ARTRA 524(g) Asbestos Trust v. Transport Insurance Co.*, 2011 WL 4501375 (N.D. Ill. Sept. 28, 2011), an asbestos trust filed suit seeking coverage under an excess policy issued to the bankrupt policyholder by Transport Insurance Company. As reported in our November 2011 Alert, *ARTRA* is one of the few cases in which a federal court has been presented with issues regarding the rights of insurers in the aftermath of a bankruptcy plan confirmed pursuant Section 524(g) of the Bankruptcy Code. In this decision, a federal magistrate judge addressed certain discovery disputes, issuing several rulings in favor of the insurer.

Both the asbestos trust (the "Trust") and Transport moved to compel production of documents that the other claimed were subject to work product protection and/or attorney-client privilege. The court granted Transport's motion to compel the production of documents relating to (1) the Trust's handling of claims and payment of prepetition settlements; and (2) the drafting of the trust distribution procedures pursuant to which the Trust was resolving asbestos claims. Applying Illinois law, the court held that the Trust, standing in the shoes of the policyholder, had a contractual obligation to cooperate with Transport. Accordingly, the Trust could not assert an attorney-client privilege over communications regarding the handling and settlement of claims that the Trust was alleging the insurer had an obligation to pay under its policies. Moreover, the Trust could not rely on the work product doctrine because the documents the Trust sought to withhold did not relate to its litigation with Transport, but rather to the underlying claims against the Trust for which it was seeking coverage from Transport.

The court also ordered the Trust to produce documents related to drafting of the trust distribution procedures created during the policyholder's bankruptcy proceedings, prior to the effective date of the Trust. Without reaching the question of whether the documents were, in fact, privileged, the court held that the Trust could not assert privilege because any potential privilege belonged to the now-dissolved Creditors Committee. Any privilege that might have protected the documents did not survive the Committee's dissolution. In any event, the court noted that the Trust had placed its distribution procedures "at issue" by seeking payment for the claims, and thus had waived any applicable privilege.

The court issued a split ruling on the Trust's motion to compel the production of reinsurance-related documents. Significantly, however, the court held that any privilege attaching to a document is not waived as a result of Transport's having shared that document with its reinsurer. Relying on the "common interest doctrine," the court found that Transport and its reinsurer shared a common interest vis-à-vis the underlying asbestos claims. Turning to the specific materials in dispute, the court issued particularized findings as to each document. Overall, the court found attorney-client privilege and work product protection for communications with counsel and for documents that contained attorneys' impressions and evaluations of the underlying claims and/or the bankruptcy proceedings. In contrast, the court ordered Transport to produce basic claims handling documents created in the routine course of business.

ARBITRATION ALERT – PREEMPTION:

Arkansas Supreme Court Rules That State Statute Prohibiting Arbitration of Insurance Disputes Trumps Federal Arbitration Act

The Arkansas Supreme Court refused to compel arbitration of an insurance contract dispute, finding that state statutory law prohibiting arbitration in insurance disputes overrode the federal interest in enforcing arbitration clauses pursuant to the Federal Arbitration Act. *S. Pioneer Life Ins. Co. v. Thomas*, 2011 WL 5583912 (Ark. Nov. 17, 2011). The contract at issue, a retail installment contract for the purchase of an automobile, contained a broad arbitration provision. The contract also provided an option to purchase credit-life insurance coverage from Southern Pioneer Life Insurance Company. A putative plaintiff class filed suit against Southern Pioneer seeking the refund of unearned credit-life insurance premiums. Southern Pioneer filed a motion to compel arbitration, and the circuit court denied the motion. The Arkansas Supreme Court affirmed.

Arkansas Code Annotated § 16-108-201(b) provides that an insurer cannot compel an insured to arbitrate claims that arise under an insurance policy. In contrast, the Federal Arbitration Act requires the enforcement of a valid agreement to arbitrate contracts involving "commerce." The central issue before the court was how to resolve these conflicting directives. Ordinarily, the FAA preempts conflicting state law. However, under the McCarran-Ferguson Act, states are entitled to regulate the business of insurance without federal intrusion. Thus, the McCarran-Ferguson Act allows reverse-preemption (i.e., state law trumping federal law) when (1) the federal statute at issue does not specifically relate to insurance; (2) the state law was enacted for the purpose of regulating the insurance industry; and (3) application of federal law will invalidate, impair or supersede the state law. Applying these factors to the present case, the court concluded that reverse-preemption applied, and that Arkansas law precluded arbitration of the dispute.

ARBITRATION ALERT – CIRCUIT SPLITS:

Seventh Circuit Rules That District Court Erred in Vacating Arbitration Award on the Basis of Manifest Disregard of the Law

The Seventh Circuit held that a "manifest disregard of the law" is not a ground upon which a district court may vacate an arbitration award under the Federal Arbitration Act. *Affymax, Inc. v. Ortho-McNeil-Janssen Pharm., Inc.*, 2011 WL 4634222 (7th Cir. Oct. 3, 2011).

The arbitration arose out of a patent dispute. The arbitration award granted joint ownership of certain patents to both parties, but sole ownership of other patents to one party. The district court confirmed the former ruling, but vacated the latter, finding that the award of the patents to one party without discussion or analysis constituted a "manifest disregard of the law." The Seventh Circuit reversed.

Section 10(a) of the Federal Arbitration Act authorizes a court to vacate an award for four reasons: (1) if procured by corruption or fraud; (2) if arbitrators were partial or corrupt; (3) if arbitrators were guilty of misconduct that prejudiced the rights of the parties; or (4) if the arbitrators exceeded their powers. The Seventh Circuit held that this list is exclusive, and may not be expanded by the parties or judge. The only exception under Seventh Circuit precedent, the court noted, is that an award may be vacated if it directs the parties to violate the legal rights of a third party who did not consent to the arbitration. Because that was not the situation here, and because the district court had not cited any of the factors set forth in Section 10(a), the Seventh Circuit reversed the district court decision and remanded the case with instructions to confirm the award in full.

The question of whether a "manifest disregard of the law" constitutes a valid basis for vacating an arbitration award is an important one after many insurance-related arbitrations and one upon which federal circuit courts disagree. In a recent ruling, the United States Supreme Court declined to resolve the issue and instead assumed, without deciding, that "manifest disregard" was a proper basis for vacatur. *See Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1768 n.3 (2010).

Fifth Circuit Declines to Stay Proceedings Pending Appeal of Court's Denial of Motion to Compel Arbitration

The Fifth Circuit ruled that there is no automatic stay when a party appeals a district court's refusal to compel arbitration and that under the circumstances presented, a discretionary stay was not warranted. *Weingarten Realty Investors v. Miller*, 2011 WL 5142183 (5th Cir. Nov. 1, 2011).

The dispute arose out of a financial transaction between the parties involving a number of interrelated contracts, only one of which contained an arbitration clause. The parties disagreed as to whether that arbitration clause governed their particular contract dispute. A Texas district court concluded that the dispute was not subject to arbitration. The party seeking arbitration appealed, and argued for a stay of district court proceedings pending resolution of the appeal. The Fifth Circuit denied a stay.

The Fifth Circuit framed the central issue as follows: Would the appeal on arbitrability involve resolution of the merits of the claims pending in the district court, thereby creating the risk that both courts would be deciding the same issues at the same time? Answering this question in the negative, the court concluded that a "determination on the arbitrability of a claim has an impact on what arbiter—judge or arbitrator—will decide the merits, but that determination does not itself decide the merits." As such, the court held an automatic stay was not necessary. The court additionally held that there was no basis for imposing a discretionary stay. Discretionary stays typically require a court to consider four factors: (1) whether the applicant has made a strong showing that success on the merits is likely; (2) whether the applicant will be irreparably injured absent a stay; (3) whether issuance of the stay will substantially injure other parties; and (4) whether public interest favors a stay. Applying these factors

to the facts presented, the court determined that a discretionary stay was not warranted.

Federal circuit courts disagree as to whether an appeal from the denial of a motion to compel arbitration divests the district court of jurisdiction to proceed to the merits and therefore creates an automatic stay. As discussed in our September 2010 Alert, the majority of circuits have held that a non-frivolous notice of appeal automatically stays proceedings in the district court, although the Second and Ninth Circuits have held that a stay is not automatic, but rather is within the discretion of the court.

STB News Alerts:

Mary Kay Vyskocil Elected President of ARIAS-U.S.

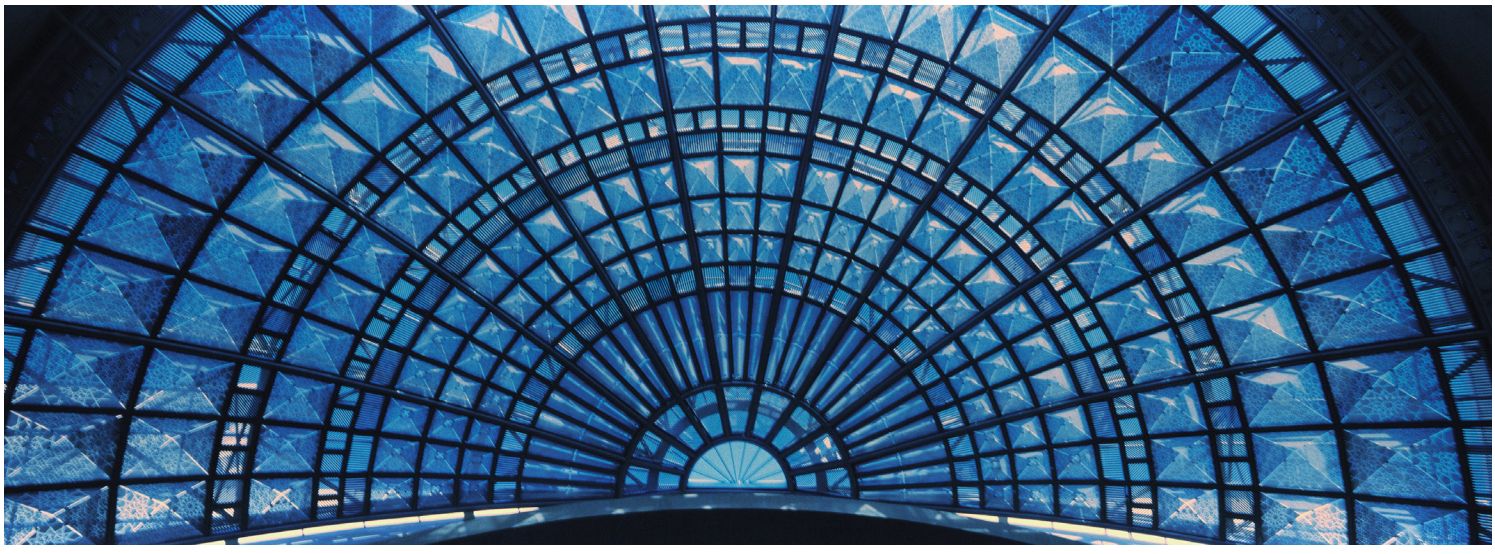
On November 3, 2011, Mary Kay Vyskocil was elected President by the members of ARIAS-U.S., a non-profit organization that focuses on improving the insurance and reinsurance arbitration process for international and domestic markets. Mary Kay is also chair of the ARIAS-U.S. Education Committee and the International Committee and has been a member of the ARIAS-U.S. board of directors for the past four years.

Andrew Amer and Linda Martin Publish Article in the Connecticut Insurance Law Journal

Andy Amer and Linda Martin's article "The Standard of Materiality for Misrepresentations Under New York Insurance Law – A State of Unwarranted Confusion" will be published in vol. 17.2 of the *Connecticut Insurance Law Journal*. The article discusses the governing standard under New York law—established by the Court of Appeals in *Geer v. Union Mutual Life Insurance Co.*—for determining whether a misrepresentation in an insurance application is material, and analyzes conflicting case law in which numerous courts have applied a subjective standard despite the objective (reasonable person) standard set forth in *Geer*. To read the full article, please click here.

Chet Kronenberg Publishes Article in the Insurance Coverage Law Bulletin

Chet Kronenberg's article "Coverage Issues Stemming from Med Pay Claims Under Commercial Premises Liability Policies" is featured in the December 2011 edition of the *Insurance Coverage Law Bulletin*. The article discusses coverage issues that have arisen in recent years with respect to medical payments provisions in commercial premises policies, including bad faith claims against insurance companies.



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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"[Simpson Thacher's insurance litigation group is] highly versed in the full range of reinsurance issues, including liability, property, marine and aviation insurance litigation."

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