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Insurance Law Alert

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"A very, very impressive team which is completely hands-on in terms of shaping the issues, and dealing with other parties and the judge."

–Chambers USA 2015 quoting a client

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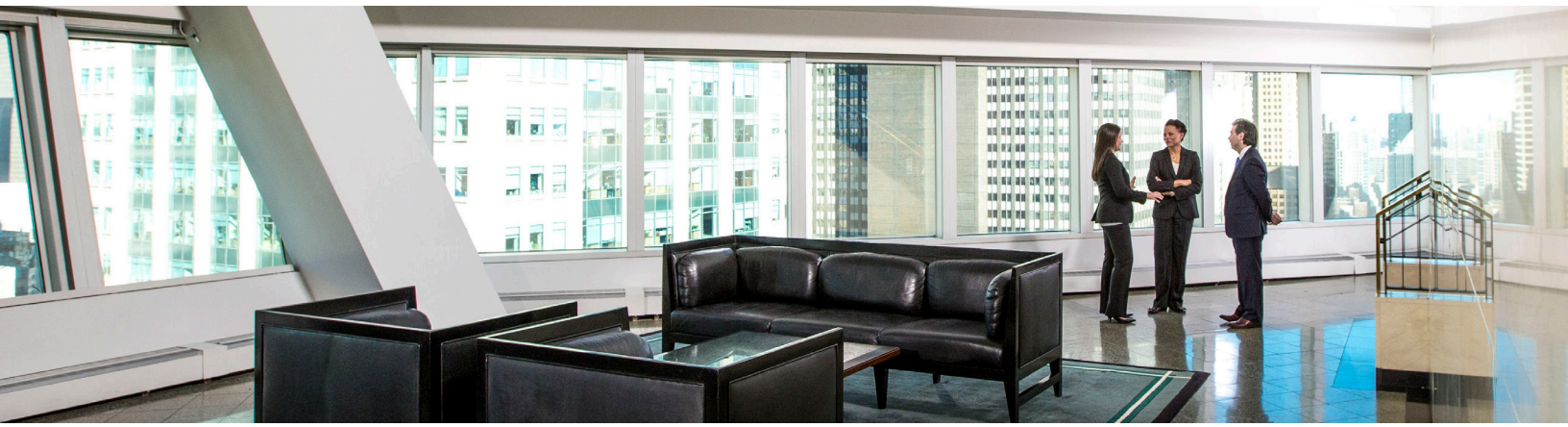
A California appellate court ruled that attorney billing records are privileged and therefore are not subject to production pursuant to the California Public Records Act. *Cnty. of Los Angeles Bd. of Supervisors v. Superior Court*, 235 Cal. App. 4th 1154 (Cal. Ct. App. 2015). (click here for full article)

Florida Court Addresses Scope of Privilege, "At Issue" Waiver and "Common Legal Interest" Doctrine

A Florida federal district court issued several potentially significant rulings as to the scope and waiver of attorney-client privilege and work-product protection. *Sun Capital Partners, Inc. v. Twin City Fire Ins. Co.*, 2015 WL 1860826 (S.D. Fla. Apr. 22, 2015). (click here for full article)



Allocation Alert:

Delaware Supreme Court Certifies Allocation and Exhaustion Questions to New York Court of Appeals

In a decade-long and highly contentious battle over millions of dollars in excess insurance coverage for asbestos injuries, the Delaware Supreme Court has certified to the New York Court of Appeals two important questions of law relating to allocation and exhaustion. *Century Indem. Co. v. Viking Pump, Inc.*, Nos. 518/523/525/528 (Del. May 28, 2015).

The litigation began in 2005, when Viking Pump sued approximately twenty excess insurers seeking coverage for tens of thousands of asbestos-related injury claims. In 2009, a Delaware Court of Chancery ruled on several issues of law, including allocation. Departing from well-established New York insurance law, the court held that coverage for injuries spanning multiple years should be allocated on an "all sums" basis, under which the policyholder can designate a single policy year to bear the responsibility for a covered loss that spans multiple policy periods. *Viking Pump, Inc. v. Century Indem. Co.*, 2 A.3d 76 (Del. Ch. Ct. 2009) (discussed in our December 2009 Alert). The court reasoned that New York had not adopted a definitive rule of law in favor of pro rata allocation and that applicable policy language, rules of contract interpretation and extrinsic evidence all favored application of "all sums" allocation. In particular, the court held that excess policy provisions relating to "non-cumulation" and "prior insurance" could not be reconciled with pro-rata allocation. Following the ruling, the case went to trial in Delaware Superior Court, and a jury ruled "substantially" in Viking Pump's favor. *Viking Pump, Inc. v. Century Indem. Co.*, 2013 WL 7098824 (Del. Super. Ct. Oct. 31, 2103). Ruling on post-trial motions, the court addressed the issue of exhaustion. The court ruled that under New York law, horizontal exhaustion applies, such that all policies of a layer of coverage must be exhausted before policies of a higher layer of coverage are triggered. In a subsequent post-trial decision, the court clarified the exhaustion ruling – one of first impression under New York law. Relying on a California decision, the Delaware court predicted that New York's highest court would rule that in continuous injury cases, horizontal exhaustion applies only to the primary and umbrella layers, but does not govern the timing of payment among excess tiers of coverage. *Viking Pump, Inc. v. Century Indem. Co.*, 2014 WL 1305003 (Del. Super. Ct. Feb. 28, 2014) (discussed in our April 2014 Alert).

This month, after hearing appellate arguments relating to the allocation and exhaustion issues, the Delaware Supreme Court certified the following questions to the New York Court of Appeals:

1. Under New York law, is the proper method of allocation to be used all sums or pro rata when there are non-cumulation and prior insurance provisions?

2. Given the Court's answer to Question #1, under New York law, when the underlying primary and umbrella insurance in the same policy period has been exhausted, what rule determines when a policyholder may access its excess insurance: vertical or horizontal?

Because a ruling by New York's highest court on these issues may affect other continuous injury and property damage coverage disputes involving multiple insurers, we will keep you posted on developments in this matter.

Coverage Alerts:

Connecticut Supreme Court Holds That Accidental Loss of Computer Data Is Not Covered by Liability Policy

Our January 2014 Alert reported on a Connecticut appellate court decision holding that claims arising out of the accidental loss of computer data were not covered by general liability policies. *Recall Total Info. Mgmt., Inc. v. Federal Ins. Co.*, 83 A.3d 664 (Conn. App. Ct. 2014). This month, the Connecticut Supreme Court affirmed. *Recall Total Info. Mgmt., Inc. v. Federal Ins. Co.*, 2015 WL 2371957 (Conn. May 26, 2015).

The dispute arose out of the loss of computer tapes containing personal data relating to approximately 500,000 IBM employees. The tapes fell out of a van during their transportation and were never recovered. The transportation company sought indemnification for mitigation and litigation expenses from its liability insurers. The insurers denied coverage. In ensuing litigation, a Connecticut trial court granted the insurers' summary judgment motion, finding that the losses were not covered by the policies. An intermediate appellate court affirmed, ruling that the loss of the computer tapes did not constitute a "personal injury," defined by the policy as injury caused by "electronic, oral, written or other publication of material that … violates a person's right to privacy." The court explained that there had been no "publication" of the lost data because there was no evidence (or even allegations) that the personal information had ever been accessed. The court rejected the argument that an invasion of privacy should be presumed because the incident triggered certain obligations under state notification statutes. The appellate court also ruled that the insurers did not waive coverage defenses by breaching their duty to defend. The court explained that there was no duty to defend because no "suit" had been filed and that settlement negotiations were not equivalent to a suit. The Connecticut Supreme Court affirmed the appellate court's decision, stating that "[w]e … adopt the Appellate Court's opinion as the proper statement of the issue and the applicable law concerning that issue."

Political Risk Policy Does Not Cover Bankruptcy-Related Losses, Says New York Appellate Court

Reversing a trial court decision, a New York appellate court ruled that a political risk insurance policy does not provide coverage for losses stemming from a foreign company's inability to repay a commercial loan due to insolvency. *CT Investment Mgmt. Co., LLC v. Chartis Specialty Ins. Co.*, 2015 WL 2184309 (N.Y. App. Div. 1st Dep't May 12, 2015).

A group of investing entities issued a $103 million loan to Mexican companies for resort development. In connection with the loan transaction, the entities obtained a political risk insurance policy that provided coverage for two types of losses: (1) losses caused by expropriatory acts by a foreign government (the "Expropriation Clause"); and (2) losses arising from a government's prohibition on currency transfers (the "Currency Clause"). The policy excluded coverage for losses "caused by or resulting from … insolvency, bankruptcy or financial default." Several years after the loan was issued, one of the borrowers initiated a voluntary insolvency proceeding under Mexican law and ceased making loan repayments. The entities sought coverage under the policy, which the insurer denied. In ensuing litigation, a New York trial court granted the insurer's motion to dismiss the claims for coverage under the Currency Clause, but refused to dismiss the claims for coverage under the Expropriation Clause. The appellate court modified the order to dismiss all claims against the insurer.

The appellate court ruled that the bankruptcy exclusion unambiguously applied to the claims. In so ruling, the court rejected the argument that the Mexican insolvency proceeding did not constitute a "bankruptcy" because there was no final adjudication under the Bankruptcy Code. Finding this interpretation "overly narrow," the court concluded that "bankruptcy" should be afforded a common sense meaning to include any "court proceeding in which the debtor is afforded judicial protection while it reorganizes or liquidates." Alternatively, the court ruled that neither the Expropriation Clause nor the Currency Clause provided coverage for the losses at issue. The court explained that the application of Mexican insolvency law (including the issuance of a stay in pending litigation) was not an "alteration" of Mexican law as required by the Expropriation Clause. Similarly, the Currency Clause, which covers losses caused by prohibitions on transfers of currency, did not apply because the freezing of loan-related accounts does not constitute a prohibition on the transfer of currency. Highlighting the distinction between political risk policies and credit policies, the appellate court stated: "[i]f the lenders were concerned about the financial stability of one or more of the borrowers, they could have purchased credit insurance to protect them from the risk of a borrower's bankruptcy."

Bad Faith Alerts:

Louisiana Supreme Court Rules That Insurer May Be Liable for Bad Faith Failure to Settle Even Absent Settlement Offer

The Louisiana Supreme Court ruled that an insurer may be liable for bad faith failure to settle under Louisiana statutory law even if the insurer did not receive a firm settlement offer. The court also held that bad faith may be based on an insurer's failure to disclose facts unrelated to policy coverage. *Kelly v. State Farm Fire & Cas. Co.*, 2015 WL 208254 (La. May 5, 2015).

The bad faith claims arose from an automobile accident between two parties, Kelly and Thomas. Following the accident, Kelly's attorney sought to initiate settlement negotiations by sending a letter and copies of medical bills to Thomas' insurer, State Farm. State Farm did not respond. More than two months later, State Farm offered to settle for policy limits ($25,000). Kelly rejected the offer. Thereafter, State Farm sent Thomas a letter noting the possibility of personal liability and suggesting that he retain independent counsel. The letter did not mention the original letter from Kelly, the settlement offer, or the amount of Kelly's medical bills. In ensuing litigation between Kelly and Thomas, Thomas was found liable and a judgment of approximately $176,000 was issued. Kelly, as assignee of Thomas' policy rights, sued State Farm for bad faith. The district court ruled in State Farm's favor, finding that State Farm had no duty to notify Thomas of Kelly's original letter to State Farm because it did not constitute a settlement offer. The court also held that State Farm could not be liable for refusing to settle without a firm settlement offer. The Fifth Circuit reversed in part and affirmed in part. The Fifth Circuit agreed that State Farm could not be liable for bad faith failure to settle because there was no formal settlement offer, but found that it could be liable for failure to communicate pertinent facts to Thomas. Noting that Louisiana appellate courts have issued mixed decisions in this context, the Fifth Circuit withdrew its opinion and sought guidance from the Louisiana Supreme Court.

Louisiana statutory law requires an insurer to make a reasonable effort to settle claims in good faith. La. R. S. 22:1973. The Louisiana Supreme Court undertook a plain language analysis of the statute and held that an insurer may be liable under section 22.1973 even absent a firm settlement offer. The court explained that the statute imposes "an affirmative duty to adjust claims fairly and promptly and to make a reasonable effort to settle claims," but makes no mention of a settlement offer as a precondition to an insurer's affirmative duties. Thus, "[t]o impose the requirement of a firm settlement offer would essentially amount to adding words not included in the statute." The court also ruled that bad faith liability could be predicated on section 22:1973 for State Farm's failure to disclose facts to Thomas, even if those facts were unrelated to policy coverage. The statute prohibits an insurer from "misrepresenting pertinent facts or insurance policy provisions relating to any coverages at issue." La. R. S. 22:1973(B)(1). The court reasoned that the use of the word "or" in the statute was disjunctive,

meaning that an insurer can be liable for misrepresenting pertinent facts or policy provisions relating to any coverages at issue. Therefore, State Farm could be held liable for bad faith based on its failure to convey pertinent information (*i.e.,* medical bills and correspondence from an injured party) to its policyholder.

Sixth Circuit Rejects Reverse Bad Faith Claim Under Kentucky Law

The Sixth Circuit rejected a reverse bad faith claim asserted by an insurer against its policyholder and refused to certify the question of the claim's viability to the Kentucky Supreme Court. *State Auto Prop. & Cas. Ins. Co. v. Hargis*, 2015 WL 2081922 (6th Cir. May 6, 2015).

After a fire destroyed Hargis's home, State Auto reimbursed her approximately $425,000 under a homeowner's policy. Thereafter, Hargis admitted that she had conspired to intentionally destroy her home in order to collect insurance proceeds. The trial court declared the policy void, awarded damages to State Auto, and dismissed Hargis's bad faith claim. The court also dismissed State Auto's reverse bad faith claim on the basis that Kentucky law does not recognize such a cause of action. The Sixth Circuit affirmed. Although Kentucky law permits first party bad faith claims by a policyholder against an insurer, the Sixth Circuit reasoned that "insureds are in need of protection that insurers are not," and that the Kentucky Supreme Court has previously rejected an insurer's challenge to a Kentucky statute that affords certain rights and remedies to insureds but provides no reciprocal rights or remedies to insurers.

Notably, a New York district court recently allowed a reverse bad faith claim to proceed in reinsurance litigation. In *Utica Mutual Ins. Co. v. Century Indem. Co.*, No. 6:13-cv-995 (N.D.N.Y. May 11, 2015), a magistrate judge granted a reinsurer's motion to amend its answer to add a counterclaim against the ceding insurer for reverse bad faith. The district court held that this ruling was not clearly erroneous, notwithstanding the absence of New York precedent recognizing such claims. Acknowledging the plausibility of a reverse bad faith claim in this context, the court emphasized the duty of "utmost good faith" owed by a cedent to its reinsurer.

Insurer Did Not Impliedly Waive Attorney-Client Privilege in Bad Faith Action, Rules South Dakota Supreme Court

The South Dakota Supreme Court ruled that an insurer did not impliedly waive attorney-client privilege in a bad faith action and that the district court erred when it ordered the insurer to produce claim files without conducting an *in camera* review. *Andrews v. Ridco, Inc.*, 2015 WL 1955644 (S.D. Apr. 29, 2015).

An injured employee sued his employer and its workers' compensation insurer alleging bad faith. The employee sought discovery of his claim file and approximately 250 other claim files that were allegedly part of a deceptive claims handling program. The insurer objected on the basis of attorney-client privilege. After a limited *in camera* review of the employee's claim file, the trial court concluded that the insurer had impliedly relied on the advice of counsel in defending against the bad faith claim and had therefore waived attorney-client privilege as to all claim files. The South Dakota Supreme Court disagreed.

The South Dakota Supreme Court ruled that the insurer did not expressly or implicitly rely on the advice of counsel as a defense. As the court noted, implicit waiver requires an affirmative act that places the privileged material at issue in the litigation, which was not established here. In so ruling, the court rejected the employee's assertion that the insurer injected advice of counsel into

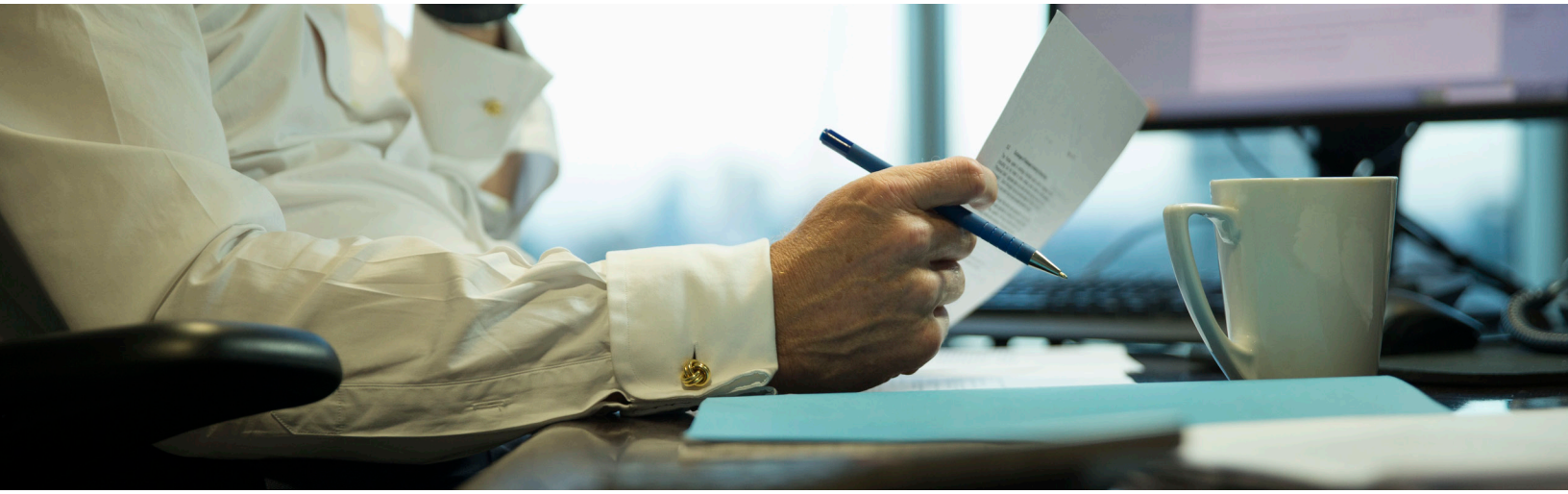
the litigation by embedding attorney-client communications into the claim file notes and then redacting those communications. The court explained: "[a]t this point in the litigation, Twin City has merely alleged that it did not act in bad faith… . Twin City has not placed at issue its subjective good-faith reliance on the advice of counsel such as would invoke an implied waiver of the … claim file notes." Finally, the court ruled that the trial court committed reversible error by failing to inspect the claim files *in camera* before making a determination as to implied waiver. Although the court declined to create an across-the-board procedural requirement for *in camera* review, it held that "the present facts establish that Twin City satisfied its burden of triggering the circuit court's obligation to conduct an *in camera* review of the disputed documents."

Whether claim file notes are privileged is commonly disputed in coverage litigation. Decisions in this context are highly fact-specific and dependent upon applicable jurisdictional law. In another recent decision addressing this issue, a New York appellate court granted a policyholder's motion to compel the production of claim file notes. *Lalka v. ACA Ins. Co.*, 2015 WL 2146923 (N.Y. App. Div. 4th Dep't May 8, 2015). There, the court held that claim file reports relating to the payment or rejection of claims were not privileged, even if prepared by attorneys. The court reasoned that claim payment decisions are "part of the regular business of an insurance company" and therefore not privileged, "even when those reports are 'mixed/multi-purpose' reports, motivated in part by the potential for litigation with the insured."

Arbitration Alert:

Recent Delaware Legislation Creates Streamlined Arbitration Process

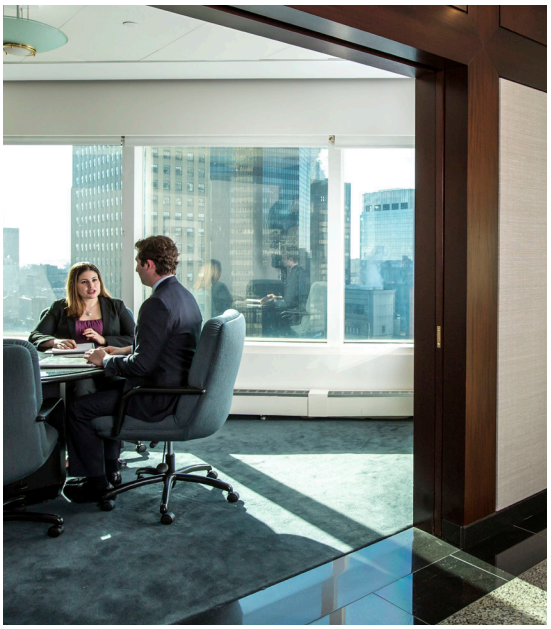
Last month, Delaware enacted the Delaware Rapid Arbitration Act ("DRAA"), a statute that seeks to expedite dramatically the arbitration process by establishing strict completion deadlines, limiting court intervention, and imposing financial penalties on arbitrators for failure to issue an award within 120 days of commencement of arbitration. *See* Chapter 58, Title 10, Delaware Code. More specifically, the DRAA eliminates interim challenges to the arbitration process and, if the parties agree, the post-award confirmation process. Specifically, if an arbitration agreement waives appellate review, the final award is automatically confirmed five business days after the award date. If review is not waived, awards are automatically confirmed within twenty days of the issuance of the arbitration decision, unless one of the parties appeals the award within fifteen days of the award's issuance. Such challenges are limited to direct appeal to the Delaware Supreme Court. The DRAA is available for most disputes involving at least one business organized under Delaware law or with its principal place of business in Delaware. However, the Act does not apply to consumer, homeowner and most shareholder actions. When contracting parties choose to invoke the DRAA, they are free to customize the structure of arbitration, including the number of arbitrators, the choice of substantive law and the location of arbitration.



Class Action Alert:

New Jersey Appellate Court Upholds Class Certification Denial Prior to Discovery

A New Jersey appellate court affirmed a trial court's denial of class certification prior to discovery in a putative class action against automobile insurers. *Myska v. New Jersey Manuf. Ins. Co.*, 2015 WL 2130870 (N.J. Super. Ct. App. Div. May 8, 2015).



Plaintiffs alleged that automobile insurers systematically and improperly denied claims for diminution in value of automobiles following car accidents. The complaint alleged breach of contract and the implied covenant of good faith and fair dealing and statutory violations. Prior to discovery, the trial court concluded that class certification was improper and that the statutory claims were not actionable. On appeal, plaintiffs argued, among other things, that the denial of class certification was premature. A New Jersey appellate court disagreed and affirmed the trial court order.

Under New Jersey law, class certification is appropriate only where common issues predominate over individualized questions and where a class action is superior to other methods of adjudication. *See* N.J. Rule 4:32-1(b)(3). Governing statutory law does not specify the timing for granting or denying class certification. Rather, it provides that "the court shall, at an early practicable time, determine by order whether to certify the action." N.J. Rule 4:32-2(a). Based on this statutory language, the court "flatly reject[ed] plaintiffs' urging to impose a bright-line rule prohibiting examination of the propriety of class certification until discovery is undertaken" and held that class certification, regardless of timing, depends on whether the claims alleged satisfy the statutory prerequisites for class certification. Here, the appellate court concluded that they did not, citing to differences in factual circumstances giving rise to each claim, as well as variations in class members' insurance policies. The appellate court also upheld the trial court's consideration of documents outside of the complaint in denying class certification because the complaint referenced those materials.

The ruling supports efforts by class action defendants to avoid the expense of class action discovery where class certification is unwarranted. The decision is also significant because state courts are commonly considered a more favorable forum than federal courts for class action suits.

Pollution Exclusion Alert:

Georgia Appellate Court Rules That Pollution Exclusion Does Not Bar Coverage for Lead Paint Injuries

Addressing an issue of first impression under Georgia law, a Georgia appellate court ruled that a pollution exclusion does not bar coverage for injuries arising out of the ingestion or inhalation of lead-based paint. *Smith v. Georgia Farm Bureau Mutual Ins. Co.*, 2015 WL 1432625 (Ga. Ct. App. Mar. 30, 2015).

Georgia Farm Bureau filed a declaratory judgment action seeking a ruling that it had no duty to defend or indemnify claims alleging lead paint-related injuries. A Georgia trial court granted the insurer's summary judgment motion, finding that the pollution exclusion barred coverage. An appellate court reversed on the basis that the term "pollutant" was ambiguous as to whether it encompassed lead or lead-based paint. The court noted the conflict among other jurisdictions regarding application of a pollution exclusion to lead paint claims, but concluded that the exclusion

should be construed narrowly in favor of the insured. Notably, the court distinguished Georgia precedent holding that a similarly-worded pollution exclusion barred coverage for carbon monoxide-related injuries.

Discovery Alerts:

California Appellate Court Deems Attorney Billing Records Privileged

Addressing a matter of first impression, a California appellate court ruled that attorney billing records are privileged and therefore are not subject to production pursuant to the California Public Records Act. *Cnty. of Los Angeles Bd. of Supervisors v. Superior Court*, 235 Cal. App. 4th 1154 (Cal. Ct. App. 2015).

The ACLU of Southern California sought the production of billing invoices of law firms hired by the County of Los Angeles to defend police brutality lawsuits. The County produced billing records for closed cases, but refused to produce statements relating to lawsuits that were still pending. The County argued that the statements were privileged under section 952 of the California Evidence Code, which defines a confidential communication as "information transmitted between a client and his or her lawyer in the course of that relationship and in confidence[,] ... includ[ing] a legal opinion formed and the advice given by the lawyer in the course of that relationship." A trial court disagreed, holding that section 952 does not apply automatically to all attorney-client communications and that privilege was not established because the County failed to assert specific facts demonstrating that the contents of the billing records qualified as privileged communications. The appellate court vacated the ruling.

The appellate court reasoned that the "proper focus in the privilege inquiry is not whether the communication contains an attorney's opinion or advice, but whether the relationship is one of attorney-client and whether the communication was confidentially transmitted in the course of that relationship." The court held that section 952 does not require the party asserting privilege to establish that the communication contains "an opinion, advice, or indeed any particular content." The court explained that the phrase "includ[ing] a legal opinion formed and the advice given by the lawyer" was not intended to restrict privilege protection solely to communications containing legal advice, and instead serves as a non-exclusive list of examples of the types of information that may be included in a confidential communication. Applying this framework to the record presented, the court concluded that the billing records were privileged because the two statutory requirements were met—*i.e.*, an attorney-client relationship existed between the County and the law firms and the billing records were transmitted between those parties during the course of representation.

Florida Court Addresses Scope of Privilege, "At Issue" Waiver and "Common Legal Interest" Doctrine

In a coverage dispute between two insurers, Twin City moved to compel the production of certain documents held by Sun Capital, including broker communications and insurance coverage analyses. Sun Capital refused to produce the materials on the basis of attorney-client privilege and work-product protection. After an *in camera* review, a Florida federal district court ordered the production of most materials, issuing several potentially significant rulings as to the scope and waiver of attorney-client privilege and work-product protection. *Sun Capital Partners, Inc. v. Twin City Fire Ins. Co.*, 2015 WL 1860826 (S.D. Fla. Apr. 22, 2015).

Work-Product Protection: The court ruled that there is a rebuttable presumption that documents prepared before a final coverage

decision is made are not protected work product, and that documents prepared after a final decision are work product. Sun Capital argued that work-product protection attached to all documents created after September 2, 2010, the date of an email from defense counsel to Sun Capital summarizing the points of contention between Sun Capital and Twin City. The court disagreed, noting that Sun Capital did not file suit until two years later and that the parties were still "actively working together towards a resolution" at that time. Instead, the court concluded that November 2, 2012, the date of Twin City's final denial letter, was the time at which Sun Capital reasonably anticipated litigation. Therefore, only documents created after that date were protected by the work-product doctrine.

"Common Legal Interest" Doctrine: Although a party generally waives attorney-client privilege when it discloses communications to a third party, most courts recognize that an exception to waiver exists if the parties who share the information have a common legal interest (or if the parties are "joint clients" of the same attorney). Here, the court ruled that Twin City and Sun Capital shared a common legal interest "in minimizing Sun Capital's liability in the underlying action, until that point that the parties reasonably anticipated litigation against each other (November 2, 2012)." Therefore, the court held that pre-November 2 communications exchanged between Sun Capital and its defense counsel and/or its broker, which related to the parties' common interest in the underlying litigation, must be produced to Twin City.

At Issue Waiver: Twin City argued that Sun Capital waived attorney-client and work-product privilege by affirmatively injecting privileged communications into the litigation. The court agreed. In particular, the court held that because Sun Capital's complaint alleged that Twin City breached its fiduciary duty by denying coverage for the underlying claim and by limiting its payment under an allocation provision, Sun Capital put "at issue" the work-product materials for the underlying claim. In addition, the court reasoned that upholding privilege would "deny Twin City access to information that would be vital to its defense." Therefore, the court ordered production of communications between Sun Capital and its defense counsel "regarding the defensibility of the underlying claims, the allocation of reimbursement for covered and non-covered losses, and communications regarding the settlement of the underlying claims."

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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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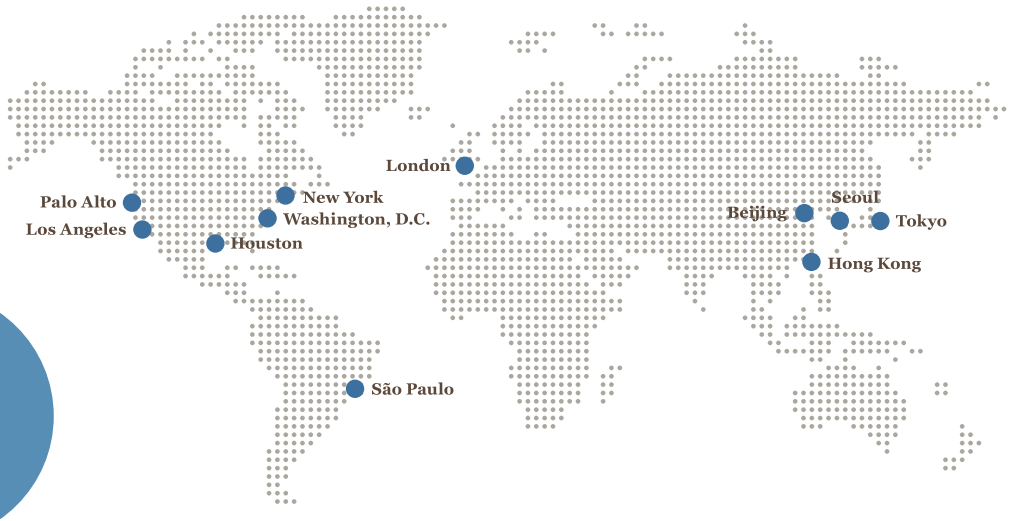

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