SIMPSON THACHER

INSURANCE LAW ALERT

OCTOBER 2010

This Alert discusses a wide range of substantive insurance and reinsurance decisions, as well as developments in the bankruptcy and discovery areas that may be significant for insurers and reinsurers. Please "click through" to view reports of interest.

- ***New York Court Awards Insurer $425 Million in Reinsurance Proceeds***
  A New York court granted Simpson Thacher clients United States Fidelity and Guaranty Company and St. Paul Fire and Marine Insurance Company summary judgment under the "follow the fortunes" doctrine, awarding more than $425 million in their reinsurance action against multiple reinsurers. *United States Fidelity and Guar. Co. v. Amercian Re-Ins. Co.*, No. 604517/02 (N.Y. Sup. Ct. Aug. 20, 2010). *Click here for full article*.

- ***Filed Rate Doctrine Bars Fraud Claims Against Insurance Company***
  A New Jersey judge applied the filed rate doctrine to dismiss numerous fraud-based claims against Prudential Insurance Company. Because resolution of certain claims and corresponding damage awards would require the court to determine reasonable premium rates, the filed rate doctrine applied and the claims were dismissed. *Clark v. Prudential Ins. Co. of Am.*, 2010 WL 3522223 (D.N.J. Sept. 9, 2010). *Click here for full article*.

- ***California Supreme Court Rules That Policyholder May Not Settle Claims With Insurer and Then Sue Insurer for Fraud***
  The California Supreme Court rejected a policyholder's attempt to employ an "affirm and sue" strategy with respect to a settlement and release agreement with its insurer. The court ruled that a policyholder may not settle an insurance claim with its insurer, execute a release of the claim, keep the money the insurer paid in the settlement without rescinding the release, and then sue the same insurer for allegedly fraudulently inducing the insured to settle the claim. *Vill. Northridge Homeowners Assoc. v. State Farm Fire and Cas. Co.*, 50 Cal.4th 913, 114 Cal. Rptr.3d 280, 282 (Cal. 2010). *Click here for full article*.

- ***Federal Magistrate Judge Recommends Sanctions and Possible Imprisonment for Discovery Violations***
  A party's willful and repeated violations of discovery orders over a period of four years culminated with a recommendation of monetary sanctions, a default judgment and a possible prison sentence for the president of the responsible party. *Victor Stanley, Inc. v. Creative Pipe, Inc.*, 2010 WL 3703696 (D. Md. Sept. 9, 2010). *Click here for full article*.

- ***Amendments to Federal Rule of Civil Procedure 26 Explicitly Create Work Product Protection for Draft Expert Reports and Attorney-Expert Communications***
  Effective December 1, 2010, Federal Rule of Civil Procedure 26, which governs disclosures related to expert opinions, is amended to afford work product protection to draft expert reports and to communications between counsel and experts expected to testify at trial. *Click here for full article*.

- ***Reimbursement of "Charges and Expenses" Under Property Policy Are Offset By Policyholder's Income***

  The Fifth Circuit ruled that the amount of "charges and expenses" to which a policyholder is entitled under business interruption coverage must be offset by income earned by the policyholder during the relevant time frame. *Consol. Cos., Inc. v. Lexington Ins. Co.*, 2010 WL 3223137 (5th Cir. Aug. 17, 2010). *Click here for full article*.

- ***Bankrupt Insured Must Pay Retained Limit Before Excess Insurer Can Be Directly Liable to Underlying Plaintiffs***

  Rhode Island's "direct action" statute, which allows a tort claimant to recover damages directly from liability insurers of a bankrupt company, does not nullify the exhaustion requirement in the company's excess insurance policies. Accordingly, tort victims may not bring a direct action against a bankrupt company's excess insurer if the bankrupt company has not paid its retained limit. *Rosciti v. Liberty Mut. Ins. Co.*, 2010 WL 3432305 (D.R.I. Aug. 30, 2010). *Click here for full article*.

- ***Where Damages Are "Highly Probable," Insured's Faulty Manufacture Does not Constitute an Occurrence***

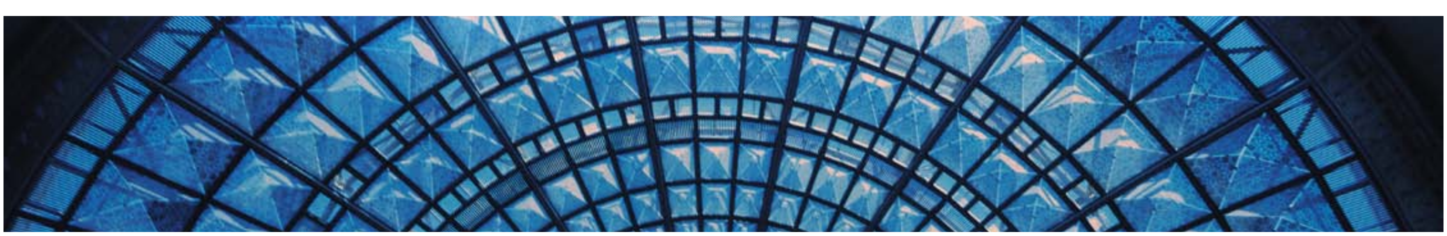
  A Texas court ruled that where a policyholder manufactured a product in a manner which resulted in damages that were "highly probable," there was no "occurrence" for insurance coverage purposes. *Nat'l Union Fire Ins. of Pittsburgh, Pa. v. Puget Plastics Corp.*, 2010 WL 3362117 (S.D. Tex. Aug. 25, 2010). *Click here for full article*.

- ***Where Delayed Reservation of Rights Does Not Harm Policyholder, No Finding of Bad Faith Against Insurer***

  A federal court rejected a policyholder's claim that a delayed reservation of rights constitutes insurer bad faith. *Am. Capital Homes, Inc. v. Greenwich Ins. Co.*, 2010 WL 3430495 (W.D. Wash. Aug. 30, 2010). Even assuming that the insurer breached its obligations by issuing an untimely reservation of rights, no prejudice resulted from the breach. *Click here for full article*.

- ***Court Bars Contribution and Indemnity Claims Against Debtor Pursuant to Section 502(e)(1)(B)***

  A federal bankruptcy judge in New York disallowed contribution and indemnity claims against Chemtura Corp., a former manufacturer of diacetyl currently in chapter 11 bankruptcy, finding that the claims were expunged under Bankruptcy Code section 502(e)(1)(B) and under applicable state law. *In re Chemtura Corp.*, 2010 WL 3521616 (Bankr. S.D.N.Y. Sept. 7, 2010). *Click here for full article*.



Reinsurance Alert:
New York Court Applies Follow the Fortunes Doctrine and Awards Insurer $425 Million in Reinsurance Proceeds

After nearly eight years of litigation, a New York court granted Travelers' affiliates United States Fidelity and Guaranty Company and St. Paul Fire and Marine Insurance Company (collectively "USF&G") summary judgment, awarding USF&G more than $425 million in its reinsurance action against multiple reinsurers, including American Re-Insurance Company (now known as Munich Reinsurance America, Inc). *United States Fidelity and Guaranty Company v. American Re-Ins. Co.*, No. 604517/02 (N.Y. Sup. Ct. Aug. 20, 2010). The court calculated the award based on a judgment of $262 million, plus pre-judgment interest at 9% dating back to the time of the reinsurance billings.

In 2002, USF&G settled for $987 million a California state insurance coverage action, *Western MacArthur Co. v. United States Fidelity and Guaranty Company*, in full satisfaction of all asbestos injury-related claims made against Western Asbestos Company. The settlement was approved as part of the MacArthur bankruptcy proceeding. USF&G paid the entire settlement out-of-pocket and billed its reinsurers for their share of the losses under their respective reinsurance treaties. The reinsurers refused to pay the amounts requested, citing a variety of reasons relating to the nature and scope of the underlying settlement payments. The court applied the "follow the fortunes" doctrine, ruling that the reinsurers were prohibited from second-guessing USF&G's settlement decisions. Because the reinsurers did not argue that the settlement was made in bad faith or that it constituted an ex gratia payment, the follow fortunes doctrine prevented the type of detailed settlement inquiries sought by the reinsurers.

USF&G was represented by Simpson Thacher partners Mary Kay Vyskocil and Chet Kronenberg. USF&G's victory in this case reinforces the principle that where an insurer enters into a good faith settlement reasonably within the scope of policy coverage, its reinsurers may not re-litigate the underlying coverage issues or contest the details of the settlement payments, but instead must "follow the fortunes" of the underlying settlement.

Regulatory Alert:
Filed Rate Doctrine Bars Fraud Claims Against Insurance Company

A New Jersey judge applied the filed rate doctrine to dismiss numerous fraud-based claims against Prudential Insurance Company. *Clark v. Prudential Ins. Co. of Am.*, 2010 WL 3522223 (D.N.J. Sept. 9, 2010). The filed rate doctrine provides that "a rate filed with and approved by a governing regulatory agency is unassailable in judicial proceedings brought by ratepayers." *Id.* at *7. In *Clark*, the court reasoned that resolution of certain claims and the fixing of a monetary damage award for those claims would require the court to determine reasonable premium rates. As such, the filed rate doctrine applied and the claims were dismissed.

Three individual plaintiffs filed a putative class

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action complaint against Prudential based on the company's purported failure to inform policyholders that it had ceased writing major medical policies to new customers. According to plaintiffs, Prudential's actions would ultimately result in a "death spiral," in which "repeated cycles of higher premiums and a continually shrinking number of health policyholders cause premiums to eventually become so high that they force policyholders to drop their policies." *Id*. at *2. Plaintiffs sought, among other things, monetary and punitive damages and injunctive relief. Prudential moved to dismiss the fraud claims brought by a New Jersey plaintiff based on the filed rate doctrine. Prudential argued that the premium rates charged to plaintiff were submitted to and approved by the New Jersey Department of Banking and Insurance (the state agency authorized to regulate insurance rates), and that resolution of plaintiff's claims (and the assessment of damages for those claims) would impermissibly require the court to evaluate the reasonableness of Prudential's premium rates. The court agreed. Although plaintiff's claims focused on Prudential's non-disclosure rather than the actual premium rates charged, the non-disclosure was directly related to the setting of premiums, the court held. Additionally, the claimed injury—that plaintiff paid higher premiums than he would have under alternative policies—directly implicated the reasonableness of the filed rates.

The *Clark* court's use of the filed rate doctrine illustrates the broad implications of the doctrine and the sometimes "harsh consequences" that its application may create, particularly in cases alleging fraud in connection with rate disclosures. *Id*. at *16. As the court noted, "there is no fraud exception to the filed rate doctrine." *Id*. at *9. Therefore, rate paying customers may be denied judicial recourse even where an insurance company (or other entity) misrepresents its rates. Under the doctrine, "customers are conclusively presumed to have constructive knowledge of the filed tariff under which they receive service." *Id*. As a result, the doctrine may bar a party from seeking legal or equitable relief "for having been misled by unconscionable sales practices which caused [a] plaintiff to enter into a contract consistent with the filed rate." *Id*. A number of courts have applied the filed rate doctrine to bar a variety of claims against health insurance companies.

Settlement Alert:
California Supreme Court Rules That Policyholder May Not Settle Claims With Insurer and Then Sue Insurer for Fraud

The California Supreme Court reversed an appellate court ruling allowing a policyholder to employ an "affirm and sue" strategy with respect to a settlement and release agreement with its insurer. The court ruled that a policyholder may not "settle a disputed insurance claim with its first party insurer, execute a full and complete release of the claim, keep the money the insurer paid in the claim settlement without rescinding the release, and then sue the same insurer for allegedly fraudulently inducing the insured to settle the claim for less than it was worth under the policy." *Vill. Northridge Homeowners Assoc. v. State Farm Fire and Cas. Co.*, 50 Cal.4th 913, 114 Cal. Rptr.3d 280,

282 (Cal. 2010). California Civil Code sections 1691 through 1693 prevent a policyholder from bringing a fraud action against its insurer where the policyholder executed a release of disputed coverage claims which explicitly bars that option. The policyholder may not "affirm those parts of the agreement that benefit it, but [ ] invalidate a major part of the agreement that benefits [the insurer]." *Id*. at 289. To sue its insurer for damages, the policyholder had to follow the general rules governing rescission of the release. The court also acknowledged the enforceability of commonly utilized settlement provisions that require policyholders to waive claims unknown to the policyholder at the time of settlement, in accordance with California Civil Code section 1542. The *Village Northridge* decision illustrates that insurers may draft settlement and release agreements so as to protect themselves against fraud claims relating to the validity of the agreement, as well as challenges based on future claims.

Discovery Alerts:

Federal Magistrate Judge Recommends Sanctions and Possible Imprisonment for Discovery Violations

A party's willful and repeated violations of discovery orders over a period of four years culminated with a recommendation of monetary sanctions, a default judgment and a possible prison sentence for the president of the responsible party. *Victor Stanley, Inc. v. Creative Pipe, Inc.*, 2010 WL 3703696 (D. Md. Sept. 9, 2010). Citing defendant's delayed production of electronically stored information ("ESI"), failure to preserve relevant information, and misrepresentations regarding the completeness of productions, a federal Magistrate Judge recommended the granting of a default judgment in favor of plaintiff on the primary copyright claim and the imposition of a prison sentence pending payment of plaintiff's attorney's fees by the president of defendant company.

The discovery abuse and resulting sanctions in *Victory Stanley* are far from typical. As the court observed, defendant's conduct constituted "the single most egregious example of spoliation that [the court] has encountered in any case … or in any case described in the legion of spoliation cases … ." *Id*. at *16. However, the decision provides a useful summary of the law of spoliation and preservation in each federal circuit. Despite the lack of a uniform national standard, there appears to be several areas of common ground. In order to prove spoliation that justifies a sanction in most federal circuits, a party typically must show that (1) the party with control over the evidence had an obligation to preserve it; (2) the loss or destruction was accompanied by a "culpable state of mind;" and (3) the destroyed evidence was relevant, in that it would have supported the claims or defenses of the party that sought it. *Id*. at *22. Practically speaking, these requirements may raise a series of case-specific questions: *When does the duty to preserve arise?* (For many jurisdictions, the duty arises when a complaint is served). *What does the duty to preserve entail?* (This generally depends on the nature and complexity of the case, and in some jurisdictions, may extend to documents under the control of third parties). *What level of culpability is sufficient to warrant sanctions?* (This likely depends on the jurisdiction, with some courts requiring bad faith, others something more than negligence, and still others, an undefined level of "fault"). *Does a finding of relevance require a showing of prejudice to the party seeking the document?* (In some cases, prejudice is presumed where the violating party acted willfully, but prejudice is generally established where a party's ability to present its case or defense is affected). *What types of sanctions are appropriate?* (This generally varies with the degree of culpability and prejudice). To complicate matters further, answers to these questions inherently involve a determination of "reasonableness under the circumstances," with an eye towards proportionality. *Id*. at *24. In other words, a party's discovery obligations may differ depending on the overall size and monetary value of a case.

Ultimately, a court's decisions regarding the duty to preserve and/or produce ESI and documentary evidence, and the appropriate sanctions for a failure to do so, will depend upon the specific facts presented and the applicable jurisdictional law.

Amendments to Federal Rule of Civil Procedure 26 Explicitly Create Work Product Protection for Draft Expert Reports and Attorney-Expert Communications

Effective December 1, 2010, Federal Rule of Civil Procedure 26, which governs disclosures related to expert opinions, is amended to clarify that work product protection is afforded to draft expert reports

and to communications between counsel and experts expected to testify at trial. The amendments also require counsel to provide a written summary of the facts and opinions of experts who are not otherwise required to file expert reports. According to Judge Mark B. Kravitz, Chair of the Judicial Conference Advisory Committee on Civil Rules, the changes will "reduce cost, focus discovery and trial on the merits of the experts' opinions, and allow parties and their counsel to make better use of their experts."

Perhaps most notable are the language changes in Rules 26(a)(2)(B)(ii) and 26(b)(4), which taken together create work product protection for draft expert reports and for communications between counsel and expert witnesses. Three categories exempted from such protection are communications related to (i) expert compensation, (ii) facts or data provided by counsel and considered by the expert in forming opinions, and (iii) assumptions provided by counsel and relied upon by the expert in forming opinions. These exceptions allow attorneys to explore any possible influence that counsel may have exerted on their experts. Amended Rule 26(b)(4)(C) clarifies that work product protection is afforded to attorney-expert communications "regardless of the form of the communications," such that it presumably applies to both oral and written communications, whether by telephone, video, e-mail, text message, or live conference. (However, this protection extends only to experts who are required to provide a report under Rule 26(a)(2)(B).) Finally, the amendments lessen the burdens often imposed upon witnesses who are expected to provide expert testimony, but who are not obligated to provide a Rule 26(a)(2)(B) report. Under amended Rule 26(a)(2)(C), counsel relying on such an expert must provide a summary of the "facts and opinions to which the witness is expected to testify." This provision will generally apply to witnesses who are not specially retained to provide expert testimony, such as party employees. Importantly, the drafts of such summaries are also afforded work product protection, by virtue of amendments discussed above. Significantly, none of the amendments affects the court's essential gatekeeping function under *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579 (1993). Similarly, the changes do not alter a party's ability to challenge the work product privilege by showing a substantial need for the material sought, which could not otherwise be obtained without undue hardship.

Why the changes to Rule 26? The amendments are aimed at remedying certain perceived problems and inefficiencies associated with Rule 26. The pre-amendment rules arguably allow discovery of virtually all attorney-expert communications and of draft expert reports. By all accounts, this resulted in enormous inefficiency and significant expense. As the Committee Notes observe, attorneys went to great lengths to avoid creating a discoverable record of expert communications, such as the hiring of two sets of experts—one for consultation and background work, and the other to provide testimony. Likewise, law firms often spent significant resources attempting to discover an adversary's expert drafts and/or communications. Alternatively, parties drafted detailed stipulations providing that draft expert reports would not be discoverable. Theoretically, the Rule 26 amendments will eradicate much of this expensive and time-consuming wrangling. Given the explicit work product protection afforded by the new amendments, attorneys and retained experts can communicate and draft more freely without fear that such communications and drafts will be discoverable by opposing counsel. Along similar lines, the new protections may permit counsel to focus on the scientific, medical or technical issues central to their case, rather than on discovery tactics.

Business Interruption Alert:

Reimbursement of "Charges and Expenses" Under Property Policy Are Offset By Policyholder's Income

The Fifth Circuit ruled that the amount of "charges and expenses" to which a policyholder is entitled under business interruption coverage must be offset by income earned by the policyholder during the relevant time frame. *Consol. Cos., Inc. v. Lexington Ins. Co.*, 2010 WL 3223137 (5th Cir. Aug. 17, 2010). Here, because the policyholder earned a net profit during the period of partial business interruption, the commercial property insurer had no obligation to reimburse the policyholder for $12 million in "charges and expenses."

Following Hurricane Katrina, Consolidated Companies was forced to suspend business operations for a short period. However, Consolidated resumed partial operations for a 15-month period before fully restoring its operations. During that 15-month period, Consolidated earned a net profit of approximately $280,000. Nonetheless, Consolidated claimed approximately $25 million under the policy, including $12 million for "charges and expenses." Under the policy, "charges and expenses" are sums that would have been incurred without the loss and which the policyholder continues to pay during the period of business interruption. Such "charges and expenses," together with a policyholder's net profit or loss resulting from the interruption, comprise the policyholder's "actual loss" under the policy. The central issue before the court was whether the $12 million in "charges and expenses" (an undisputed sum) should be paid in full by Lexington, or whether it was offset by the net profit generated during the 15-month period. Adopting the latter view, the Fifth Circuit reasoned that "when a partial resumption in operations reduces the 'actual loss' … so substantially as to create some profit, all charges and expenses have, by definition, been overcome by income. The only recovery in such an event is for the diminished profit." *Id*. at *6. Accordingly, the court vacated the $12 million "charges and expenses" jury verdict against Lexington.

Ruling on a related issue, the Fifth Circuit held again that a policyholder's lost profits under business interruption coverage should not be based on the policyholder's post-catastrophe business experience. Rather, business interruption losses should be based on the policyholder's historical sales figures. In other words, the calculation of lost profits must be based on a scenario in which the hurricane did not strike at all, not on a scenario in which the hurricane struck, but did not damage the policyholder's facilities. This principle was endorsed by the Fifth Circuit in *Caitlin Syndicate Ltd. v. Imperial Palace of Miss.*, 600 F.3d 511 (5th Cir. 2010) (Mississippi law), a decision highlighted in our May Alert. Here, the Fifth Circuit ruled that this rule of policy interpretation applies with equal force under Louisiana law. *See also Finger Furniture Co. v. Commonwealth Ins. Co.*, 404 F.3d 312, 314 (5th Cir. 2005) (applying same principle under Texas law).

Excess Alert:
Bankrupt Insured Must Pay Retained Limit Before Excess Insurer Can Be Directly Liable to Underlying Plaintiffs

Rhode Island's "direct action" statute, which allows a tort victim to recover damages directly from liability insurers of a bankrupt company, does not nullify the exhaustion requirement in the company's excess insurance policies. Accordingly, tort victims may not bring a direct action against a bankrupt company's excess insurer if the bankrupt company has not paid its retained limit. *Rosciti v. Liberty Mut. Ins. Co.*, 2010 WL 3432305 (D.R.I. Aug. 30, 2010).

This matter arose out of negligence claims against Monaco Coach Corp., relating to the sale of an allegedly defective mobile home. Because Monaco filed a bankruptcy petition, the tort victims turned to Monaco's insurers, including the Insurance Company of the State of Pennsylvania ("ICSOP"). The plaintiffs invoked Rhode Island Gen. Laws 1956 § 27-7-2.4 (2010), which provides that a tort victim "may file a complaint directly against the liability insurer of the alleged tortfeasor seeking compensation by way of a judgment for money damages whenever the alleged tortfeasor files for bankruptcy … " *Id.* at *1. The issue here was that ICSOP did not provide primary insurance to Monaco. Rather, Monaco was self-insured for the first $500,000 of liability. Accordingly, ICSOP argued and the court agreed that each of ICSOP's excess policies required Monaco to pay out the full retained limit before ICSOP's liability could be implicated.

As a preliminary matter, the court ruled that the plain language of the excess policies make clear that ICSOP is not obligated to "drop down" to pay the retained limit in the event of Monaco's bankruptcy. Furthermore, the court concluded that § 27-7-2.4 does not override the exhaustion requirement in the excess policy. Although the statute does not explicitly address exhaustion requirements, it provides that the tort victim "shall not recover an amount in excess of the insurance coverage available"—language which supports the enforcement of the exhaustion provision. *Rosciti* joins a significant number of court decisions holding that excess insurers are generally not required to "drop down" in the event of a policyholder's bankruptcy (and consequential inability to pay retained limits). *Id.* at *8.

Occurrences Alert:
Where Damages Are "Highly Probable," Insured's Faulty Manufacture Does Not Constitute an Occurrence

A Texas court ruled that where a policyholder manufactured a product in a manner which resulted in damages that were "highly probable," there was no "occurrence" for insurance coverage purposes. *Nat'l Union Fire Ins. of Pittsburgh, Pa. v. Puget Plastics Corp.*, 2010 WL 3362117 (S.D. Tex. Aug. 25, 2010). Puget, a manufacturer of plastic water chambers for use in water heaters, was found liable by a jury for deceptive practices, fraud and various tortuous acts. Puget's liability arose from its decision to manufacture the water chambers in such a way that resulted in leaks and other failures. National Union, Puget's insurer, argued that it had no duty to defend or indemnify Puget. The court agreed, ruling that there was no "occurrence" under the National Union policy. Although deliberate acts may constitute an occurrence in some instances, Puget's deliberate conduct in this case was not an occurrence because the resulting damage was "highly probable" and was "the natural and expected result of [Puget]'s action." *Id.* at *3.

Although *Puget Plastics* is a faulty manufacture case rather than a faulty workmanship case, the decision reinforces existing Texas law on the frequently litigated issue of whether (and under what circumstances) faulty workmanship triggers general liability insurance coverage. According to Texas Supreme Court precedent, faulty workmanship may constitute an occurrence where it results in unexpected and unforeseen property damage. *Lamar Homes v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007). Puget extends this principle to the intentional manufacture of a product, reasoning that faulty manufacturing does not constitute an occurrence where the resultant damage was likely. Courts in many other jurisdictions have ruled that defective work, standing alone does not constitute an occurrence. Only faulty workmanship that results in unexpected bodily injury or property damage to something other than the faulty work itself can constitute an occurrence. Last month, two courts reiterated this principle. *See Concord Gen. Mut. Ins. Co. v. Green & Co. Bldg. and Dev. Corp.*, No. 2009-699 (N.H. Sept. 17, 2010) (under New Hampshire law, an insurer has no duty to indemnify against faulty workmanship that did not result in bodily injury or damage to other property); *Scottsdale Ins. Co. v. R.I. Pools Inc.*, No. 09-cv-01319 (D. Conn. Sept. 2010) ("Although an accident can be a consequence of faulty workmanship, faulty workmanship alone is not an accident"; insurer has no duty to defend claims alleging negligent construction of pools).

Bad Faith Alert:
Where Delayed Reservation of Rights Does Not Harm Policyholder, No Finding of Bad Faith Against Insurer

A federal court rejected a policyholder's claim that a delayed reservation of rights constitutes insurer bad faith. *Am. Capital Homes, Inc. v. Greenwich Ins. Co.*, 2010 WL 3430495 (W.D. Wash. Aug. 30, 2010). Even assuming that the insurer breached its obligations by issuing an untimely reservation of rights, no prejudice resulted from the breach. Despite the delay, the policyholder was able to select its own counsel in the underlying action and arrived at a settlement fully funded by the insurer. Therefore, even if the reservation of rights was issued in a bad faith manner, the insurer demonstrated that the policyholder did not suffer any prejudice as a result. The policyholder's generalized contention that the delay adversely affected the manner in which it conducted the defense was irrelevant, the court held. Regardless of how the policyholder's actions may have been affected, it "cannot point to a dollar lost or to a case in support of their contention that these speculative losses amount to actual harm." *Id.* at *5.

Bankruptcy Alert:
Court Bars Contribution and Indemnity Claims Against Debtor Pursuant to Section 502(e)(1)(B)

In a decision of interest to insurers of corporate debtors, a federal bankruptcy judge in New York disallowed contribution and indemnity claims against Chemtura Corp., a company in chapter 11 bankruptcy, finding that the claims were expunged under Bankruptcy Code section 502(e)(1)(B) and under applicable state law. *In re Chemtura Corp.*, 2010 WL 3521616 (Bankr. S.D.N.Y. Sept. 7, 2010).

Chemtura, a former manufacturer of diacetyl (a chemical used in the manufacture of butter flavorings)

was named as a defendant in numerous lawsuits, along with various other distributors, manufacturers and suppliers. In the bankruptcy proceedings, Chemtura objected to proof of claims filed by several corporate claimants for contribution and/or indemnification on two grounds: (1) to the extent that the corporate claimants have yet to incur any obligation to tort plaintiffs, the unliquidated and contingent portion of the contribution claims are disallowed under section 502(e)(1)(B); and (2) with respect to obligations that the corporate claimants have already incurred pursuant to settlements with tort victims, Chemtura is not obligated to contribute because those settlements did not preserve the corporations' right to seek contribution from Chemtura under applicable state law. *Id*. at *4.

A claim is disallowed under section 502(e)(1)(B) of the Bankruptcy Code if three conditions are met: (i) the claim is for reimbursement or contribution; (ii) the party asserting the claim is liable with the debtor on the claim of a third party; and (iii) the claim is contingent at the time of its allowance or disallowance. *Id*. The court concluded that all three requirements were satisfied here. The court rejected the notion that co-liability (requirement (ii)) cannot be established where tort plaintiffs had not filed a proof of claim against Chemtura before the bar date. Similarly, the court rejected the argument that for co-liability to exist, "some additional nexus must exist as between co-defendants in the underlying lawsuit," such that the successful prosecution of the underlying claims against one party automatically results in liability against the co-defendant. *Id*. at *6. Neither of those assertions is supported by the text of section 502(e)(1)(B). The only exception to the finding of co-liability, the court held, was with respect to defense costs. To the extent that the corporate claimants assert claims for defense costs, the court ruled that co-liability was not established because defense costs differ from traditional contribution claims.

The court also ruled that the corporate claimants' contribution claims for payments already made to third parties were disallowed under state law. Under applicable state law (in Illinois, Colorado and Missouri), a settling tortfeasor may not recover contribution from a joint tortfeasor whose liability is not extinguished by the settlement. The corporate claimants may not avoid application of this principle by labeling their claim as one for "implied indemnity" rather than contribution, the court explained. Additionally, Chemtura's liability cannot be considered extinguished simply because tort plaintiffs failed to file a proof of claim before the bar date. Although such claims are generally extinguished, late claims may still be considered in chapter 11 cases under various circumstances, and the final validity of claims is not determined until a bankruptcy plan is confirmed. Accordingly, the court ruled that the corporate claimants did not establish valid contribution claims on their respective settlements.

Simpson Thacher News Alert:

STB partner Bryce L. Friedman authored an article entitled *Medical Monitoring and General Liability Insurance: An Uncertain Prognosis for Coverage*, which discusses whether claims seeking medical monitoring trigger general liability insurance coverage. The article summarizes relevant case law in this emerging context, including a recent class action suit brought by a Louisiana fisherman against BP, PLC and other entities. Mr. Friedman's article was quoted in Forbes Magazine's blog, please click here to view.

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

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"[Simpson Thacher] is undoubtedly one of the leading insurer firms in the USA."

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