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Insurance Law Alert

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"They're the go-to firm for the insurance industry for really serious cases. Their practice is top-notch."

***–Chambers USA 2016,* quoting a client**

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The Ninth Circuit ruled that a California federal district court erroneously concluded that an insurer's negligence was sufficient to constitute a breach of the implied duty to settle. *McDaniel v. Government Employees Ins. Co.*, 2017 WL 892516 (9th Cir. Mar. 7, 2017). (Click here for full article)

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The Sixth Circuit ruled that an insurer had no duty to defend or indemnify infringement and false advertising claims because they did not allege disparagement within the scope of advertising injury coverage. *Vitamin Health, Inc. v. Hartford Cas. Ins. Co.*, 2017 WL 1325263 (6th Cir. Apr. 11, 2017). (Click here for full article)

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Texas Supreme Court Announces Five Rules Of Law Governing Policyholders' Statutory and Contractual Rights To Damages

Seeking to eliminate confusion among Texas courts, the Texas Supreme Court set forth five rules addressing when an insured can recover policy benefits or other damages based on statutory violations, absent a breach of contract by the insurer. *USAA Texas Lloyds Co. v. Menchaca*, 2017 WL 1311752 (Tex. Apr. 7, 2017). (Click here for full article)

Arbitration Alerts:

New York Court Vacates Reinsurance Award Based On Arbitrator's Evident Partiality

A New York federal district court vacated an arbitration award in a reinsurance dispute, finding that an arbitrator's failure to disclose his relationship with a party to the dispute reflected evident partiality. *Certain Underwriting Members at Lloyd's of London v. Insurance Co. of the Americas*, No. 16-CV-323 (S.D.N.Y. Mar. 31, 2017).

ICA, an insurance company that provides workers' compensation coverage, entered into reinsurance treaties with certain Lloyd's underwriters. When a dispute over two claims arose, ICA demanded arbitration and designated Alex Campos as its arbitrator. Before arbitration began, each panel member made affirmative disclosures regarding his relationships with the parties and individuals involved in the dispute. In his disclosure, Campos indicated that he had no personal relationship with any party or any business relationship with ICA. At the end of arbitration, the panel issued an award in ICA's favor. The Underwriters moved to vacate the award on several bases, including Campos's evident partiality. The court granted the motion.

Under the Federal Arbitration Act, an award may be vacated based on evident partiality if the moving party establishes by clear and convincing evidence that "a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration." The court concluded that this standard was met because Campos failed to disclose his extensive business relationships with ICA and individuals associated with ICA. In particular, the court noted that shortly before arbitration began, Campos hired Ricardo Rios (the Treasurer, Secretary and Director of ICA) to serve as the CFO for Vensure Employee Services (of which Campos was the President and CEO). Noting that Rios was listed as a potential witness and was seated at ICA's table throughout the course of arbitration, the court deemed it "troubling" that the relationship between Campos and Rios was not disclosed. Similarly, other ICA directors were listed on the Vensure website as officers and were revealed to have prior dealings with Campos. Furthermore, Vensure and ICA operated out of the same suite at the same address.

In granting Underwriters' motion to vacate, the court rejected ICA's contentions that partiality was not established because Campos had no financial or personal stake in the outcome of the arbitration and that a more relaxed standard of impartiality applies for "party appointed arbitrators in tripartite industry arbitrations." However, the court cautioned that evident partiality must be analyzed on a case-by-case basis and that a failure to disclose a material relationship does not constitute *per se* partiality.

California Supreme Court Rules Unenforceable Portion Of Arbitration Clause That Waives Right To Public Injunctive Relief

The California Supreme Court ruled that an arbitration provision that waives the right to seek public injunctive relief in any forum is contrary to public policy and thus unenforceable under California law. *McGill v. Citibank, N.A.*, 2017 WL 1279700 (Cal. Apr. 6, 2017).

Sharon McGill filed a putative class action against Citibank, claiming that the marketing and administration of its "credit protector" insurance plan violated California consumer protection laws. She sought monetary relief, punitive damages and injunctive relief. Citibank moved to compel arbitration based on an arbitration clause in the consumer contract. A trial court granted the motion in part, ordering arbitration of the monetary claims, but suspended arbitration for the injunctive claims based on California common law which holds that agreements to arbitrate claims for public injunctive relief (*i.e.,* injunctive relief that benefits the general public rather than just one individual) under certain statutes are unenforceable.

An appellate court reversed, ruling that the Federal Arbitration Act preempts state law in this context. The California Supreme Court reversed.

Addressing a preliminary matter, the court held that McGill's complaint sought public injunctive relief authorized under state statutory law. The court then concluded that the arbitration provision at issue was invalid under state law insofar as it purported to waive McGill's statutory right to seek such relief. Citibank argued that even if California law precludes a waiver of the right to seek pubic injunctive relief, state law is preempted by the FAA. The court disagreed, finding Citibank's view of the FAA "overbroad." The court explained that the "saving clause" of the FAA permits arbitration agreements to be declared unenforceable "upon such grounds as exist at law or in equity for the revocation of any contract." The saving clause applies here, the court concluded, because California law permits the revocation of contracts that purport to waive, in all fora, the statutory right to seek public injunctive relief.

In so ruling, the court distinguished *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013) (discussed in our July/August 2013 Alert) and *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011) (discussed in our May 2011 Alert). In both cases, the United States Supreme Court ruled that the FAA preempts state law that precludes class action waivers in arbitration. The California Supreme Court reasoned that *Concepcion* reaffirmed that the "saving clause permits agreements to arbitrate to be invalidated by 'generally applicable contract defenses' under state law" and that in any event, the procedural issue of class action waivers is qualitatively different than waivers of substantive statutory remedies. The court remanded the matter for a determination of whether the remainder of the arbitration provision remains enforceable.

Stacking Alert:

California Court Rules That Non-Cumulation Clause Prevents Insured From Stacking Policy Limits

A California federal district court ruled that a non-cumulation clause is an anti-stacking provision and therefore that the policyholder is entitled to recover only a single policy limit rather than the sum of three consecutive policy limits. *Ins. Co. of the State of PA. v. Cnty. of San Bernardino*, No. CV 16-0128 (C.D. Cal. Mar. 8, 2017).

The County had incurred approximately $30 million in environmental cleanup costs and expects to incur substantially more in projected costs. The Insurance Company of the State of Pennsylvania ("ICSOP") sought a declaration of its obligations under three umbrella liability policies issued to the County of San Bernardino. Each policy contains a $9 million per occurrence limit, as well as a "non-cumulation" provision that states: "if any loss covered hereunder is also covered in whole or in part under another excess policy … the limit of liability hereon … shall be reduced by any amounts due to the Assured on account of such loss under such prior insurance." The parties disputed whether this provision operates as an "anti-stacking clause." Finding the provision unambiguous, the court held that it does.

Under California law, stacking is permissible "as a default" under standard policy language, but insurers may include anti-stacking provisions to limit coverage. Although the court noted that the ICSOP policies at issue (sold in the 1960s and 1970s) did not contain the explicit anti-stacking verbiage commonly included in more recent policies, the court held that the effect of the language at issue is the same. The court explained that the only reasonable interpretation of the provision is to reduce the limits of policies in later years by the amounts due under earlier policies for ongoing, continuous damage. The court rejected various arguments asserted by the County, including that the clause constituted an impermissible escape clause.

Number of Occurrences Alerts:

Iowa Court Adopts Per-Claim Approach To Number Of Occurrences In A Defective Product Suit

An Iowa federal district court ruled that each claim against a window manufacturer is a separate occurrence for purposes of general liability coverage. *Pella Corp. v. Liberty Mutual Ins. Co.*, 2017 WL 1231721 (S.D. Iowa Mar. 31, 2017).

Numerous claims were filed against Pella based on its allegedly defective design, manufacture and/or installation of windows. In addressing the number-of-occurrences issue, the court focused on fifteen of the highest value claims (the "Sample Claims"). The parties agreed that Iowa law uses a cause-based analysis but disagreed "regarding the level of generality at which that concept should be applied." Pella argued that each Sample Claim alleges a separate occurrence because each claim presents unique underlying circumstances. In contrast, Liberty Mutual asserted that the Sample Claims allege three occurrences, based on the three general causes of damage (falling through a window; improper installation; and defective design). Alternatively, Liberty Mutual argued that largest category of claims (defective design) could be subdivided into two separate occurrences – defective windows and defective sealant/glazing.

Finding both interpretations of "occurrence" to be reasonable, the court concluded that the term was ambiguous. Therefore, the court construed the policy in Pella's favor, holding that each Sample Claim constitutes a separate occurrence.

Each Incident Of Abuse Is A Separate Occurrence, Says Minnesota Bankruptcy Court

A Minnesota bankruptcy court ruled that each incident of abuse by an individual priest is a separate occurrence under liability policies. *In re Diocese of Duluth*, 2017 WL 1194501 (Bankr. D. Minn. Mar. 30, 2017). Numerous insurers sought declarations as to coverage for sexual abuse claims against the Diocese of Duluth. Liberty Mutual argued that various acts of abuse by different priests against multiple victims arose from one occurrence—the Diocese's negligent supervision of the priests. Rejecting this argument, the court explained that under Minnesota law, each incident of sexual abuse caused injury and thus constituted a separate identifiable occurrence. However, the court held that under the deemer clause, all abuse against one victim by the same priest is deemed one occurrence.

Fourth Circuit Affirms That Fireworks-Related Injuries Arise From Single Occurrence

Applying Pennsylvania law, the Fourth Circuit ruled that injuries caused by a fireworks-related accident arose from a single occurrence, regardless of the number of victims or alleged negligent acts. *Hollis v. Lexington Ins. Co.*, 2017 WL 1076706 (4th Cir. Mar. 22, 2017).

During a fireworks show, Kathryn Hollis and her two sons sustained serious injuries caused by the misfiring of a firework into the crowd. Hollis sued numerous parties, alleging negligence based on the violation of nineteen separate duties of care. Lexington, which insured the fireworks company, sought a declaration that its coverage obligation was limited to a $1 million per-occurrence limit. Lexington argued that under Pennsylvania's cause-based test, the underlying claims arose from a single occurrence—the fireworks incident. A Virginia federal district court agreed and granted Lexington's summary judgment motion. The district court rejected Hollis's argument that the claims arose from nineteen occurrences, corresponding with the number of duties that the fireworks company allegedly breached. The district court noted that "[a]lthough many breaches of duty contributed to this accident as but-for causes, those breaches involved only one proximate cause of injury: the negligent explosion of the firework shell. Consequently, the Underlying Complaint alleges only a single occurrence under Pennsylvania law." The district court also rejected the argument that the existence of multiple tortfeasors supports a finding of multiple occurrences. The Fourth Circuit affirmed for the reasons cited by the district court.

Additional Insured Alerts:

Indiana Court Of Appeals Rules That Insurer Owes No Additional Insured Coverage Until Named Insured Satisfies SIR

Addressing a matter of first impression under Indiana law, the Indiana Court of Appeals ruled that a named insured under a general liability policy must satisfy the self insured retention ("SIR") before an additional insured may seek coverage under the policy. *Walsh Constr. Co. v. Zurich American Ins. Co.*, 2017 WL 1151033 (Ind. Mar. 28, 2017).

Walsh, a general contractor, hired Roadsafe as a subcontractor in the construction of a traffic exchange. Roadsafe obtained a general liability policy and named Walsh as an additional insured, as required by the parties' indemnity contract. The policy included a $500,000 per-occurrence SIR endorsement. When a claimant sued Walsh for injuries sustained in the construction zone, Walsh sought additional insured coverage under the policy. Zurich denied coverage based on Roadsafe's failure to pay the SIR. A trial court ruled in Zurich's favor and the Indiana Court of Appeals affirmed.

The question on appeal was whether the SIR endorsement amends Zurich's obligation to defend Walsh as an additional insured. Walsh and Roadsafe argued that the endorsement amends only Zurich's relationship to Roadsafe, whereas Zurich argued that the SIR amount must be satisfied before Zurich has any obligations under the contract. The court agreed with Zurich, finding that the SIR payment was an unambiguous condition precedent to any coverage under the policy. The court reasoned that the SIR shifts the initial cost burden from Zurich to Roadsafe for coverage costs, not just for Roadsafe's damages and defense costs. The court noted that if Walsh disapproved of its subcontractors obtaining SIR endorsements in policies under which it was an additional insured, it could have precluded that in its indemnity contract with Roadsafe.

New York Appellate Court Rules That Insurer Is Estopped From Denying Coverage Based On Failure To Timely Disclaim Coverage To Additional Insured

A New York appellate court ruled that an insurer is estopped from denying coverage to an additional insured based on its failure to timely disclaim coverage. *Harco Constr., LLC v. First Mercury Ins. Co.*, 2017 WL 986586 (N.Y. App. Div. 2d Dep't Mar. 15, 2017).

Harco Construction hired a subcontractor, Disano, to assist with demolition of a building. Pursuant to the contract, Harco was listed as an additional insured under a liability policy that First Mercury issued to Disano. Harco was also insured under its own liability policy, issued by Mt. Hawley. When an accident occurred during demolition, Mt. Hawley notified First Mercury and sought confirmation that Harco and the owner of the property were additional insureds under the policy. In a letter response to Mt. Hawley, First Mercury disclaimed any duty to defend or indemnify Harco based on a policy exclusion. First Mercury did not disclaim coverage as to the property owner and did not send notice of its disclaimer to Harco or the property owner. In ensuing coverage litigation, the parties disputed First Mercury's coverage obligations as to Harco and the property owner.

The appellate court ruled that First Mercury was obligated to send written notice of its disclaimer directly to Harco under N.Y. Insurance Law § 3420(d). The court explained that while Mt. Hawley was "acting on behalf of" Harco when it sent notice of the occurrence to First Mercury, Mt. Hawley was not Harco's agent for the purpose of receipt of notice of a disclaimer. Thus, First Mercury's failure to provide timely notice of a disclaimer directly to Harco resulted in a waiver of that coverage defense.

However, the court ruled that First Mercury was not obligated to issue a disclaimer to the property owner, because he was not an additional insured under the policy. The court explained that an insurer is not required to disclaim coverage under § 3420(d) when the denial is based on a lack of coverage in the first place, rather than a policy exclusion.

Choice of Law Alert:

Rejecting Site-Based Choice Of Law Approach, Delaware Supreme Court Rules That New York Law Governs All Environmental Claims

Reversing a Superior Court decision, the Delaware Supreme Court ruled that New York law governs an environmental coverage dispute regardless of the state in which the claims arose. *Certain Underwriters at Lloyds, London v. Chemtura Corp.*, 2017 WL 1090544 (Del. Mar. 23, 2017)

In this coverage dispute between a chemical company and its insurers, the parties disagreed as to which state's law should govern policy interpretation. Applying Delaware's most significant relationship framework, a Delaware Superior Court ruled that the policy should be interpreted under the respective laws of the states where the underlying environmental claims arose. Under the Superior Court ruling, Arkansas and Ohio law (both of which have utilized an "all sums" approach to allocation) applied, respectively, to claims arising in those states. The Delaware Supreme Court reversed.

The Delaware Supreme Court agreed with the lower court's most significant relationship approach, but concluded that New York law (which has endorsed pro rata allocation) should govern the entire dispute given its contacts to the parties and contract formation. Emphasizing the importance of "certainty, predictability and uniformity of result," the court stated:

> This result … fulfills the need for comprehensive insurance programs to have a single interpretive approach utilizing a single body of law unless the parties to the scheme choose otherwise. Precisely because this is an insurance scheme covering diverse nationwide risks, the relationship of the parties cannot center in a rotating and ever-changing way on where the insurer happens to be sued currently, resulting in the policy being read in fundamentally different ways in different cases, based on the happenstance of where, across a broad variety of possible locations and jurisdictions, potential liability results in litigation.

Settlement Alert:

Ninth Circuit Rules That Insurer's Negligence Is Insufficient To Establish Breach Of Implied Duty To Settle

The Ninth Circuit ruled that a California federal district court erroneously concluded that an insurer's negligence was sufficient to constitute a breach of the implied duty to settle. *McDaniel v. Government Employees Ins. Co.*, 2017 WL 892516 (9th Cir. Mar. 7, 2017).

McDaniel, as assignee of claims against GEICO, alleged that the insurer breached its implied duty to settle by refusing to accept a $100,000 policy limits settlement, after which a $3 million award was issued against the policyholder. A California district court agreed and granted McDaniel's summary judgment motion. The Ninth Circuit reversed, holding that an insurer breaches its implied duty to settle only when it engages in "unreasonable conduct." While the conduct need not rise to the level of fraud or dishonesty, it must consist of more than negligence, bad judgment or mistake. The court held that GEICO's conduct did not satisfy the "unreasonable refusal" standard because its failure to accept the policy limits offer was based on negligence. In particular, the record established that GEICO's failure to accept the offer within the required time frame was due to a miscommunication relating to the receipt of certain discovery

responses, and that GEICO had attempted to accept the settlement offer (without realizing that the time frame had expired).

Advertising Injury Alert:

Sixth Circuit Rejects Policyholder's Implicit Disparagement Argument For Advertising Injury Coverage

The Sixth Circuit ruled that an insurer had no duty to defend or indemnify infringement and false advertising claims because they did not allege disparagement within the scope of advertising injury coverage. *Vitamin Health, Inc. v. Hartford Cas. Ins. Co.*, 2017 WL 1325263 (6th Cir. Apr. 11, 2017).

Bausch & Lomb sued Vitamin Health alleging patent infringement and false advertising based on Vitamin Health's advertisements for vision-related supplements. Vitamin Health's insurer, Hartford, refused to defend or indemnify, arguing that the underlying complaint did not allege product disparagement. A Michigan federal district court agreed and granted Hartford's summary judgment motion. *See* May 2016 Alert. This month, the Sixth Circuit affirmed.

The Sixth Circuit ruled that the underlying complaint could not be read to allege that Vitamin Health disparaged Bausch & Lomb's products. The complaint alleged that Vitamin Health misrepresented the content of its own products, not its competitors' products. Additionally, the court rejected the notion that Vitamin Health "implicitly disparaged" Bausch & Lomb's products by creating a false comparison between the two companies' products. The court expressed uncertainty as to whether Michigan law recognizes claims of disparagement by implication, but held that even assuming it does, Vitamin Health failed to allege such a claim. The underlying complaint did not allege that Vitamin Health made assertions of product superiority, thereby implying that competitors' products were inferior. As such, Hartford had no duty to defend or indemnify the claims.

Statutory Alerts:

Minnesota Supreme Court Rules That State Statute Caps Damages At Policy Limits

The Minnesota Supreme Court ruled that a state statute that authorizes damages to an insured when an insurer unreasonably denies policy benefits is subject to a cap based on policy limits. *Wilbur v. State Farm Mutual Auto. Ins. Co.*, 2017 WL 1245282 (Minn. Apr. 5, 2017).

Minnesota statutory law provides a remedy for first-party policyholders when an insurer denies a claim without a reasonable basis. Under the statute, a court may award "an amount equal to one-half the proceeds awarded that are in excess of an amount offered by the insurer at least ten days before the trial begins or $250,000, whichever is less." Minn. Stat. § 604.18. The court ruled that the phrase "proceeds awarded" refers to an amount capped by the insurance policy limit, explaining that the term "proceeds" indicates a monetary amount defined by an insurance policy. Based on this interpretation, the policyholder's statutory damages were limited to $36,000 (one-half the difference between policy limits and the insurer's settlement offer), rather than $114,578.30 (one-half the difference between the final jury award and the insurer's settlement offer).

Texas Supreme Court Announces Five Rules Of Law Governing Policyholders' Statutory and Contractual Rights To Damages

Seeking to eliminate the "substantial confusion" among Texas courts, the Texas Supreme Court set forth five rules addressing when an insured can recover policy benefits or other damages based on statutory violations, absent a breach of contract by the insurer. *USAA Texas Lloyds Co. v. Menchaca*, 2017 WL 1311752 (Tex. Apr. 7, 2017).

Menchaca sought coverage under a property policy for hurricane-related damage. USAA denied coverage based on an adjuster's report indicating that the amount of damage was lower than the policy's deductible. Menchaca sued USAA for breach of contract and violation of the Texas Insurance Code, seeking benefits under the policy. A jury concluded that USAA did not breach the insurance policy

but did engage in unfair or deceptive practices under state statutory law (*i.e.*, refusing to pay a claim without conducting a reasonable investigation). Based on this finding, the jury awarded Menchaca approximately $11,000 in damages. Both parties moved for judgment based on the verdict. USAA argued that absent a breach of contract, Menchaca could not recover extra-contractual damages, whereas Menchaca claimed that the USAA's statutory violation justified the damages award. The trial court ruled in Menchaca's favor and an appellate court affirmed. The Texas Supreme Court reversed.

Addressing the relationship between breach of contract claims under an insurance policy and claims under the Insurance Code, the court announced the following five rules:

The General Rule: An insured cannot recover policy benefits as damages for an insurer's statutory violation if the policy does not provide the insured a right to receive those benefits.

The Entitled-to-Benefits Rule: An insured who establishes a right to receive benefits under a policy can recover those benefits as actual damages under the Insurance Code if the insurer's statutory violation causes the loss of benefits.

The Benefits-Lost Rule: Even if the insured cannot establish a contractual right to policy benefits, the insured can recover benefits as actual damages under the Insurance Code if the insurer's statutory violation caused the insured to lose that contractual right.

The Independent-Injury Rule: If an insurer's statutory violation causes an injury that is independent of the loss of policy benefits, the insured may recover damages for that injury even if the policy does not grant the insured a right to benefits.

The No-Recovery Rule: An insured cannot recover damages based on an insurer's statutory violation if the insured had no right to receive benefits under the policy and did not sustain any injury independent of a right to benefits.

The Texas Supreme Court remanded the matter for a new trial in the interests of justice.

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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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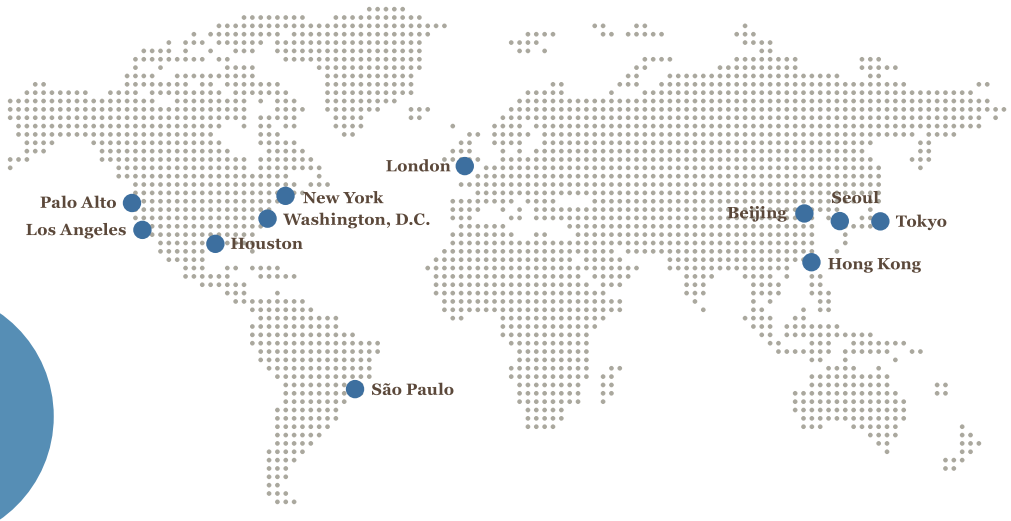

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