SIMPSON THACHER

INSURANCE LAW ALERT

FEBRUARY 2012

This Alert addresses decisions relating to the allocation of defense and indemnity costs, an excess insurer's duty to defend, the scope of business interruption coverage, and an insurer's right to restitution of settlement payments from a policyholder. We also discuss a New York decision that overrules previous precedent regarding the timeliness for issuing coverage disclaimers and a federal appellate court decision dismissing a class action against several insurers on jurisdictional grounds. In addition, we summarize case law regarding the admissibility of expert testimony in insurer bad faith actions. Finally, we analyze several noteworthy arbitration-related rulings and two significant decisions in the bankruptcy context. Please "click through" to view articles of interest.

- ***Policyholder May Not Change Allocation Scheme***

  A Wisconsin court rejected a policyholder's attempt to lump together three individual excess insurance policies in an effort to simultaneously obtain defense and indemnity costs from those insurers on a pro rata basis years after procuring a "joint and several" allocation ruling. *Cleaver-Brooks, Inc. v. AIU Ins. Co.*, No. 11-CV 10292 (Wis. Cir. Ct. Milwaukee Cty. Dec. 7, 2011) (Transcript). *Click here for full article*

- ***Utah Supreme Court Endorses Pro Rata Allocation of Defense Costs, Rejecting "Equal Shares" Approach***

  The Utah Supreme Court held that defense costs must be allocated between two successive insurers on a pro rata time-on-the-risk/policy limits basis. *Ohio Cas. Ins. Co. v. Unigard Ins. Co.*, 2012 WL 29325 (Utah Jan. 6, 2012). *Click here for full article*

- ***Federal Circuit Court Affirms Dismissal of Class Action Bond Dispute***

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- ***Insurer's Disclaimer of Coverage May Not Await Investigation of Claim or Other Policy Defenses, Says New York Appellate Court***

  A New York appellate court held that an insurer must notify a policyholder as soon as it believes it has a basis on which to disclaim coverage, even if the insurer's investigation of the claim (and of other, independent grounds for disclaiming coverage) is ongoing. *George Campbell Painting v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA.*, 2012 N.Y. Slip Op. 00254 (1st Dep't Jan. 17, 2012). *Click here for full article*

- ***Primary Insurers' Refusal to Defend Does Not Trigger Excess Insurer's Defense Obligations***

  The Ninth Circuit held that an excess insurer has no duty to defend an underlying action by virtue of the primary insurers' refusal to defend, unless primary policy limits have been exhausted. *Nat'l Union Fire Ins. Co. of Pittsburgh, PA. v. Seagate Techs., Inc.*, 2012 WL 169703 (9th Cir. Jan. 20, 2012) (unpublished opinion). *Click here for full article*

- ***Texas Court Rejects Coverage for Partial Suspension of Business Operations***

  A Texas district court ruled that a commercial property insurer did not owe business interruption coverage to an insured motel where some, but not all, of the hotel's rooms were rendered unusable due to hurricane damage. *H&H Hospitality LLC v. Discover Specialty Ins. Co.*, 2011 WL 6372825 (S.D. Tex. Dec. 20, 2011). *Click here for full article*

- ***Utah Supreme Court Rejects Insurer's Restitution Claim Against Policyholder for Payments in Excess of Policy Limits***

  The Utah Supreme Court held that an insurer may not seek restitution of settlement payments in excess of policy limits from a policyholder where the insurance contract does not explicitly provide for such claims. *U.S. Fidelity & Guarantee Co. v. U.S. Sports Specialty Ass'n*, 2012 WL 192793 (Utah Jan. 24, 2012). *Click here for full article*

- ***Finding That Thorpe Plan of Reorganization Is Not "Insurance Neutral" and That Non-Settling Insurers Have Standing to Appeal, Ninth Circuit Reverses Confirmation of Plan***

  The Ninth Circuit reversed a district court judgment affirming confirmation of Thorpe Insulation Company's plan of reorganization, finding that insurers had standing to object to the plan and that the insurers' objections were not equitably moot. *In re Thorpe Insulation,* 2012 WL 178998 (9th Cir. Jan. 24, 2012). *Click here for full article*

- ***Delaware Court Rejects Challenges to Grace's Plan of Reorganization***

  A federal district court in Delaware confirmed the Joint Plan of Reorganization filed by W.R. Grace & Co., rejecting numerous challenges to the Joint Plan by various objecting parties, including asbestos claimants' insurance-related challenges. *In re W.R. Grace & Co.,* 2012 WL 310815 (D. Del. Jan. 30, 2012). *Click here for full article*

- ***New York Court Declines to Enforce $55 Million International Arbitration Award***

  A federal district court in New York denied the petition of a Brazilian airline to enforce in the United States an international arbitration award against certain business entities, finding that the entities had not agreed to arbitrate the dispute at issue in the Brazilian tribunal. *VRG Linhas Aereas S.A. v. MatlinPatterson Global Opportunities Partners II L.P.*, No. 11 CV 198 (S.D.N.Y. Jan. 19, 2012) (Transcript). *Click here for full article*

- ***Third Circuit Enforces Arbitration Provision Despite Unavailability of Designated Arbitration Forum***

  The Third Circuit held that the Federal Arbitration Act requires appointment of a substitute arbitrator where the arbitrator designated by the parties in the arbitration agreement is unavailable. *Khan v. Dell Inc.*, 2012 WL 163899 (3d Cir. Jan. 20, 2012). *Click here for full article*

- ***Another Federal Court Relegates Issue of Consolidation to Arbitration Panel***

  The Fourth Circuit held that the question of whether multiple arbitrations should be consolidated into a single proceeding must be decided by an arbitration panel, rather than a court, and that until such a ruling was made, the court would not appoint neutral arbitrators for incomplete panels. *Arrowood Indem. Co. v. Harper Ins. Co.*, 2012 WL 161667 (W.D.N.C. Jan. 19, 2012). *Click here for full article*

- ***Kentucky Court Allows Expert to Opine as to Unreasonableness of Insurance Company's Settlement Offer, But Not as to Insurer Bad Faith***

  A federal court in Kentucky issued a mixed evidentiary ruling in a first party automobile insurance dispute, holding that a policyholder's expert was permitted to testify as to what the insurance company's initial settlement offer should have been, but was not permitted to state that the insurance company acted in bad faith. *Nevels v. Deerbrook Ins. Co.*, 2011 WL 6304066 (E.D. Ky. Dec. 16, 2011). *Click here for full article*

- ***Virginia Supreme Court Agrees to Rehear Coverage Dispute Over Global Warming Claims***

  The Virginia Supreme Court agreed to rehear arguments relating to a previous decision in which the court held that an insurer did not owe defense or indemnity under comprehensive general liability policies for global warming-related claims because the underlying complaint did not allege an "occurrence." *AES Corp. v. Steadfast Ins. Co.*, No. 100764 (Va. rehearing ordered Jan. 17, 2012). *Click here for full article*

- ***STB News Alerts***

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Allocation Alerts:

Policyholder May Not Change Allocation Scheme

A Wisconsin court rejected a policyholder's attempt to lump together three individual excess insurance policies in an effort to simultaneously obtain defense and indemnity costs from those insurers on a pro rata basis years after procuring a "joint and several" allocation ruling. Rather, the court held, each excess insurer's obligations is dictated by the specific terms in its respective policy and by Wisconsin law, which endorses a joint and several approach to allocation. *Cleaver-Brooks, Inc. v. AIU Ins. Co.*, No. 11-CV-10292 (Wis. Cir. Ct. Milwaukee Cty. Dec. 7, 2011) (Transcript).

A manufacturer of asbestos-containing products was named as a defendant in numerous bodily injury lawsuits. Three insurance companies, AIU, National Union and Lexington, each issued a separate liability policy to the manufacturer's parent company during the same time frame. All three polices provided excess coverage, to attach after $15 million in underlying coverage had been exhausted. The AIU and National Union policies contained a duty to defend, but the Lexington policy did not. Coverage litigation between the parties (as well as other insurers) ensued, and in a previous decision (the "2007 Judgment"), the court held that all insurance policies triggered by asbestos-related bodily injury claims were jointly and severally liable to the policyholder (subject to proof of exhaustion of underlying policies). In the 2007 Judgment, the court explicitly rejected pro rata apportionment of defense and indemnity costs, finding that policy language did not support such allocation. In accordance with this ruling, National Union has been defending the asbestos cases and covering 100% of the settled claims.

In a newly filed coverage case against certain excess insurers only, however, the policyholder took the contrary position that the costs of settling asbestos claims should be allocated on a pro rata basis among AIU, National Union and Lexington, and that defense costs should be allocated equally between National Union and AIU. Under the scheme advanced by the policyholder, all three policies would share settlement costs simultaneously and would exhaust at the same time. According to the policyholder, this new allocation scheme would have provided substantially more defense coverage than under the 2007 Judgment. The court declined to change the allocation scheme mid-stream. Citing to the 2007 Judgment, the court reiterated that the insurers' defense and indemnity obligations were governed by a joint and several approach, and that each insurer's obligations was derived from its

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respective insurance policy. In so ruling, the court stated that the policyholder was receiving precisely what it had bargained and paid for under the individual excess insurance policies. The court stated: "The fact there might be a gap because Lexington has no duty to defend [the policyholder] is not a result of National Union and AIU utilizing other insurance provisions; instead, it is consequences of [the policyholder]'s failure to contract for the duty to defend."

In the most recent round of litigation, National Union, AIU and Lexington were represented by Simpson Thacher partners Mary Beth Forshaw and Bryce Friedman. This case is part of a recent trend in which policyholders seek to reopen coverage rulings that they once found favorable but years later, no longer serve their interests.

Utah Supreme Court Endorses Pro Rata Allocation of Defense Costs, Rejecting "Equal Shares" Approach

Answering a question certified by the Tenth Circuit, the Utah Supreme Court held that defense costs must be allocated between two successive insurers on a pro rata time-on-the-risk/policy limits basis. The court rejected the notion that the apportionment of defense costs for successive insurers should be based on the "equal shares" method referenced in the insurance policies' "other insurance" clauses. *Ohio Cas. Ins. Co. v. Unigard Ins. Co.*, 2012 WL 29325 (Utah Jan. 6, 2012).

Ohio Casualty and Unigard issued policies to two mutual insureds, with Ohio Casualty covering a one-year period, and Unigard covering a subsequent three-year period. During a six month phase in between the two policy periods, the companies were uninsured. When the companies were sued for breach of contract, fraud and numerous trade infringements, they tendered their defense to Ohio Casualty and Unigard. Unigard accepted the tender under a reservation of rights, but Ohio Casualty denied a defense. Unigard then filed a motion seeking a ruling as to Ohio Casualty's duty to defend and the proper method of allocating defense costs. The Utah district court concluded that both insurers had a duty to defend the underlying action, and that defense costs were to be shared equally between the insurers. The district court relied on the identical "other insurance" clauses in the Unigard and Ohio Casualty policies, which provided for equal sharing. Ohio Casualty appealed the ruling, and the Tenth Circuit posed the following question to the Utah Supreme Court: "Should defense costs … be allocated between Ohio Casualty and Unigard under the 'equal shares' method set forth in the 'other insurance clause' of Ohio Casualty's policy, or, in the alternative, … should those defense costs be allocated using the time-on-risk method … ?"

The Utah Supreme Court ruled that the "other insurance" clauses had no application in the context of allocating costs among successive (rather than concurrent) insurance policies. Further, the court held that under Utah precedent and equitable principles, defense costs must be apportioned based on a time-on-the-risk basis, taking into account the amount of each policy's limits. However, the court declined to apportion defense costs to the policyholders for the six-month period of no insurance, reasoning that the insurers' exclusive right to control the litigation would make it unreasonable to require the policyholder to share in the defense costs.

Jurisdiction Alert:
Federal Circuit Court Affirms Dismissal of Class Action Bond Dispute

The United States Court of Appeals for the Federal Circuit affirmed the dismissal of a putative class action against several insurers that had issued single-transaction customs bonds guaranteeing the payment

of anti-dumping duties on certain goods imported from China. *Sioux Honey Ass'n v. Hartford Fire Ins. Co.*, 2012 WL 379626 (Fed. Cir. Feb. 7, 2012).

In 2009, domestic producers of honey, mushrooms, crawfish and garlic brought a putative class action in the United States Court of International Trade against the United States, the Department of Commerce, U.S. Customs and Border Protection, as well as a number of insurers. The complaint alleged that the sureties issued single-transaction customs bonds guaranteeing the payment of anti-dumping duties that the United States had assessed on imports of honey, mushrooms, crawfish and garlic originating from China. According to the complaint, thinly capitalized importers had defaulted on payment of hundreds of millions of dollars in anti-dumping duties payable on these goods. The complaint alleged that the Government had neglected to collect the anti-dumping duties from the sureties and the sureties were wrongfully refusing to pay the Government under the bonds. The domestic producers contended that, because they had a known statutory right to recoup from the Government a ratable portion of the anti-dumping duties payable under the customs bonds, they were intended third-party beneficiaries of those bonds with standing to sue the sureties directly.

The Court of International Trade dismissed all claims against the sureties on the merits in 2010. The court reasoned that because the anti-dumping statutes and implementing regulations do not "make[] plaintiffs intended third-party beneficiaries of the customs bonds that they seek to place at issue in this case," plaintiffs lacked standing to assert contractual rights under the bonds. According to the court, nothing in the statutory scheme, regulations, legislative history, or contractual language indicated any intent to "create rights in any private party or confer a benefit upon a private party." In a second opinion, the court dismissed all claims against the Government on a variety of grounds. The domestic producers appealed the dismissal of certain claims to the Court of Appeals for the Federal Circuit, including the breach of contract claim against the sureties and the Government premised on the theory that domestic producers were intended third-party beneficiaries of the bonds.

On February 7, 2012, the Federal Circuit affirmed the dismissal of the claims against the sureties on jurisdictional grounds. The Federal Circuit held that the Court of International Trade lacked authority to exercise supplemental jurisdiction over the claims against the sureties under (1) the Customs Courts Act, or (2) common law pendent jurisdictional standards. The court went on to dismiss the breach of contract claims against the Government, holding that domestic producers were not, at any rate, intended third-party beneficiaries of the bonds and thus lacked enforcement rights under those bonds. Relying on the Supreme Court's recent decision in *Astra USA, Inc. v. Santa Clara County*, 131 S. Ct. 1342 (2011), the Federal Circuit thus concluded that any benefits the domestic producers might derive from the contracts were indirect and thus domestic producers were not intended third-party beneficiaries of the bonds.

Simpson Thacher partner May Kay Vyskocil argued the appeal for the insurers. Barry R. Ostrager and Michael J. Garvey were on the prevailing brief.

Disclaimer Alert:
Insurer's Disclaimer of Coverage May Not Await Investigation of Claim or Other Policy Defenses, Says New York Appellate Court

Overruling its own precedent, a unanimous panel of the New York Appellate Division, First Department, held that an insurer must notify a policyholder as soon as it believes it has a basis on which to disclaim coverage, even if the insurer's investigation of the claim (and of other, independent grounds for disclaiming coverage) is ongoing. *George Campbell Painting v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA.*, 2012 N.Y. Slip Op. 00254 (1st Dep't Jan. 17, 2012).

Insurance Law § 3420(d) requires a liability insurer to provide written notice of disclaimer of a personal injury claim "as soon as is reasonably possible." In a 2004 ruling, the New York appellate division held that notwithstanding § 3420, an insurer is "not required to disclaim on timeliness grounds before conducting a prompt, reasonable investigation into other possible grounds for disclaimer." *DiGuglielmo v. Travelers Prop. Cas. Co.*, 776 N.Y.S.2d 542, 544 (1st Dep't 2004); *leave to appeal denied*, 3 N.Y.3d 608 (1st Dep't 2004). In last month's *George Campbell Painting* decision, the First Department overruled *DiGuglielmo*, reasoning that it was inconsistent with the statutory language of § 3420(d), New York Court of Appeals precedent, and public policy considerations. The court held that "§ 3420(d) precludes an insurer from delaying issuance of a disclaimer on a ground that the insurer knows to be valid—here, late notice of the claim—while investigating other possible grounds for disclaiming." The court concluded that because the insurer had sufficient knowledge of a late notice defense nearly four months before it provided a written disclaimer to the policyholder, the disclaimer was ineffective as a matter of law. In so ruling, the court deemed it irrelevant that during the four-month period, the insurer was actively investigating whether certain defendants in the underlying action were additional insureds under the applicable policy, and that the insurer had been in constant communication with the policyholder (and had in fact issued several requests for copies of applicable policies) during that time frame.

In overruling *DiGuglielmo*, the First Department is now aligned with the Second Department in this context. As such, insurers with policies governed by New York law are well advised to issue written disclaimers as soon as they "[f]irst learn[ ] of the grounds for disclaimer of liability or denial of coverage," regardless of any ongoing investigation relating to the claim and/or scope of coverage. As *George Campbell Painting* illustrates, a failure to do so may result in a waiver of otherwise valid defenses.

Excess Alert:
Primary Insurers' Refusal to Defend Does Not Trigger Excess Insurer's Defense Obligations

Reversing a district court ruling, the Ninth Circuit held that an excess insurer has no duty to defend an underlying action by virtue of the primary insurers' refusal to defend, unless primary policy limits have been exhausted. *Nat'l Union Fire Ins. Co. of Pittsburgh, PA. v. Seagate Techs., Inc.*, 2012 WL 169703 (9th Cir. Jan. 20, 2012) (unpublished opinion). The appellate court explained that even where the policyholder's potential liability exceeds primary policy limits and the primary insurers have refused to defend, the excess insurer owes no duty until the primary insurers' limits have been exhausted. Ruling in favor of the insurers on another issue, the Ninth Circuit also held that even though the primary insurers' refusal to defend was improper, it was not unreasonable, and thus could not form the basis for a bad faith claim. Under California law, an insurer's denial of coverage or defense typically does not constitute bad faith unless the denial was unreasonable or without cause.

Business Interruption Alert:

Texas Court Rejects Coverage for Partial Suspension of Business Operations

A Texas district court ruled that a commercial property insurer did not owe business interruption coverage to an insured motel where some, but not all, of the hotel's rooms were rendered unusable due to hurricane damage. *H&H Hospitality LLC v. Discover Specialty Ins. Co.*, 2011 WL 6372825 (S.D. Tex. Dec. 20, 2011).

The policy at issue covered loss of business income sustained because of a "necessary suspension of operations." The court held that this language unambiguously requires a complete cessation of business activities at the covered premises in order for business interruption coverage to apply. As such, the court rejected the hotel's contention that the court should consider "the nature of the premises at issue" in determining what constitutes a "necessary suspension of operations" and that given its status as a hotel, the business interruption provision should be interpreted to provide coverage where *some* of the rooms experienced a suspension of operations.

Discover Specialty comports with numerous other rulings which, in the face of similar policy language, have held that a total cessation of business activities was necessary in order to invoke business interruption coverage. However, when presented with differing policy language (such as "necessary or *potential* suspension of business" or "total or *partial*" interruption of operations), courts have permitted coverage. This body of case law illustrates the importance of careful policy drafting for business interruption provisions so as to eliminate any possibility of ambiguity regarding the scope of intended coverage.

Restitution Alert:

Utah Supreme Court Rejects Insurer's Restitution Claim Against Policyholder for Payments in Excess of Policy Limits

The Utah Supreme Court held that an insurer may not seek restitution of settlement payments in excess of policy limits from a policyholder where the insurance contract does not explicitly provide for such claims. *U.S. Fidelity & Guarantee Co. v. U.S. Sports Specialty Ass'n*, 2012 WL 192793 (Utah Jan. 24, 2012).

USF & G issued a liability policy to the United States Sports Specialty Association ("USSSA") with a coverage limit of approximately $2 million. When USSSA was sued in a bodily injury action, USF & G assumed the defense. The trial resulted in a verdict of more than $6 million against USSSA. Following the verdict, the parties filed various post-trial motions and eventually proceeded to mediation. USF & G ultimately entered into a settlement with the underlying plaintiff, over the objections of USSSA, for $4.8 million. Pursuant to the settlement, USF & G issued a "unilateral reservation of rights" that purported to allow USF & G to seek reimbursement from USSSA for the approximate $2.8 million of the settlement that exceeded policy limits. USSSA refused to sign the settlement. Nonetheless, USF & G paid the underlying plaintiffs and filed a satisfaction

of judgment. USF & G filed an action against USSSA seeking, among other things, restitution for the amount paid in excess of policy limits.

The Utah Supreme Court held that "an insurer's right to reimbursement from an insured must be expressly provided in an insurance policy before it can be enforced." The court explained that restitution is an equitable remedy designed to prevent unjust enrichment where a contractual remedy does not exist. However, where an express contract exists—such as the insurance contract at issue here—recovery for unjust enrichment is not available. The court explained: "To allow such a cause of action in the face of an enforceable contract governing the parties' rights would effectively add or modify terms for which they had not bargained." If the parties had intended to allow restitution as an available remedy, the insurance contract should have expressly provided for it, the court held.

Courts across jurisdictions disagree as to whether an insurer may seek reimbursement of settlement costs (or for that matter, defense costs) from a policyholder after there has been a finding of no coverage (or no duty to defend). Some jurisdictions (such as California) have allowed such claims based on a theory of unjust enrichment or (where a policyholder is silent in the face of a unilateral reservation of rights to seek reimbursement) a theory of implied contract. However, other jurisdictions have reasoned that absent an express policy provision, an insurer has no right to reimbursement. *See* September 2010, January 2011, June 2011 Alerts (discussing conflicting decisions relating to an insurer's right to reimbursement of defense and/or settlement costs). Decisions in the latter category, such as *U.S. Fidelity*, place insurers in a precarious situation in which they may be forced to choose between indemnifying potentially uncovered claims (and/or paying more than policy limits in connection with a settlement) on the one hand, or a risk a bad faith claim on the other hand. In *U.S. Fidelity*, the Utah Supreme Court dismissed this quandary, noting that threats of bad faith should have little influence on an insurer if it has fulfilled its contractual obligations.

Bankruptcy Alerts:

Finding That Thorpe Plan of Reorganization Is Not "Insurance Neutral" and That Non-Settling Insurers Have Standing to Appeal, Ninth Circuit Reverses Confirmation of Plan

The Ninth Circuit reversed a district court judgment affirming confirmation of Thorpe Insulation Company's plan of reorganization. Although the Ninth Circuit agreed with the district court that federal bankruptcy law preempted the anti-assignment clauses in the non-settling insurers' policies, the Ninth Circuit disagreed with the district court that the insurers lacked standing to object to the plan. *In re Thorpe Insulation*, 2012 WL 178998 (9th Cir. Jan. 24, 2012). Accordingly, the Ninth Circuit remanded to the district court with instructions to return the case to the bankruptcy court to give the insurers "a full and fair opportunity to present evidence and be heard … before the bankruptcy court."

Ruling on a preliminary jurisdictional matter, the court rejected the argument that the appeal was constitutionally and/or equitably moot. On the issue of standing, the Ninth Circuit concluded that the insurers had both "bankruptcy standing" (standing to object to the confirmation of the plan in bankruptcy court) and "appellate standing" (standing to appeal that confirmation ruling). The Ninth Circuit disagreed with the bankruptcy court's finding that the plan was "insurance neutral," reasoning that the plan could substantially impact the insurers in several ways: *First*, the plan might have a preclusive effect in asbestos suits brought against the insurers by claimants. *Second*, the plan would not necessarily permit the insurers to challenge settlement amounts as unreasonable. *Third*, if the trust ran out of money, the channeling injunctions would preclude claimants from seeking damages from any insurers other than the non-settling insurers. *Fourth*, any inadequacy in the trust's funding could

also impact the non-settling insurers because "any costs that [the insurers] could have recovered against it will be lost."

In light of the Ninth Circuit's decision, there will likely be evidentiary proceedings that may or may not yield modifications to the current plan of reorganization.

Delaware Court Rejects Challenges to Grace's Plan of Reorganization

A federal district court in Delaware has confirmed the Joint Plan of Reorganization filed by W.R. Grace & Co. In a 200-page opinion, the district court affirmed the bankruptcy court's Memorandum Opinion, Findings of Fact and Conclusions of Law, rejecting numerous challenges to the Joint Plan by objecting parties including asbestos claimants from Libby, Montana (the "Libby Claimants"), BNSF Railway, the State of Montana, bank lenders and others. *In re W.R. Grace & Co.*, 2012 WL 310815 (D. Del. Jan. 30, 2012).

In overruling the Libby Claimants' objections, the court found the Joint Plan's channeling injunction, issued pursuant to Section 524(g) of the Bankruptcy Code, to be clear and unambiguous. The court held the injunction provides enough specificity and detail to put all parties on notice of its prohibition against pursuing claims for derivative liability against insurers protected by the injunction. The court rejected the Libby Claimants' argument that the injunction improperly barred independent claims against settled insurers for their own alleged wrongful conduct, finding that it was premature to decide the extent to which such claims are derivative. Significantly, the court also rejected the Libby Claimants' arguments that they had a vested right in the debtor's insurance, finding that the proceeds of Grace's insurance policies "are payable to Grace, *not* the Libby Claimants" (emphasis in original). The Libby Claimants contended that they had rights to Grace's insurance coverage that "vested" at the time of their injuries and that such rights could not be terminated by any settlement between Grace and its insurers. They also contended that their claims were non-products claims and were entitled to greater compensation because Grace's insurance provides a greater percentage of coverage for its non-products claims than its products claims. The court rejected these arguments, holding that because the Libby Claimants were not named as insureds or intended beneficiaries under Grace's policies, and there was no evidence that the policies were purchased for their benefit, the Libby Claimants held no direct rights to the insurance proceeds and could not establish any statutory, common law or public policy basis upon which they held any interest in the policies. *In re Thorpe Insulation* and *In re W.R. Grace & Co.* are important rulings against efforts to breach insurers' hard-earned protections in asbestos bankruptcies.

Arbitration Alerts:

New York Court Declines to Enforce $55 Million International Arbitration Award

On January 19, 2012, a federal district court in New York denied the petition of a Brazilian airline to enforce in the United States an international arbitration award of $55 million against business entities represented by Simpson Thacher partners Robert Smit and Tyler Robinson. *VRG Linhas Aereas S.A. v. MatlinPatterson Global Opportunities Partners II L.P.*, No. 11 CV 198

(S.D.N.Y. Jan. 19, 2012) (Transcript). The airline sought to enforce the award pursuant to the United Nations Convention on the Recognition and Enforcement of Arbitral Awards (the "Convention"). Under the Convention, such international arbitration awards are presumptively enforceable in the United States except under narrow exceptions. Here, enforcement of the Brazilian arbitration award was denied because the court was convinced that there was no agreement to arbitrate the particular contractual dispute at issue. Therefore, the court agreed that the business entities were not subject to the jurisdiction of the Brazilian arbitral tribunal in the first place.

Insurance and reinsurance disputes involving foreign entities or foreign liabilities may similarly implicate the Convention and give rise to complex issues relating to international comity, contract interpretation and federal policy favoring the enforcement of arbitration provisions. However, in any such case, a key and possibly outcome-determinative factor will likely be the language, scope and interpretation of the contractual agreement to arbitrate—as was the case in *VRG Linhas*.

Third Circuit Enforces Arbitration Provision Despite Unavailability of Designated Arbitration Forum

Reversing a New Jersey district court decision, the Third Circuit held that the Federal Arbitration Act requires appointment of a substitute arbitrator where the arbitrator designated by the parties in the arbitration agreement is unavailable. *Khan v. Dell Inc.*, 2012 WL 163899 (3d Cir. Jan. 20, 2012).

The contract at issue, a purchase agreement between a consumer and an electronics manufacturer, contained an arbitration clause that required all contract disputes to be "resolved exclusively and finally by binding arbitration administered by the National Arbitration Forum (NAF)." By the time the contract dispute arose, however, the NAF had been barred from conducting

consumer arbitrations as a result of a government investigation relating to its arbitration practices. Thus, the central question before the court was whether the arbitration clause in the parties' contract was rendered unenforceable because it required the parties to arbitrate exclusively before a forum that was no longer available.

Under federal case law interpreting the FAA, the unavailability of a contractually designated arbitrator is not necessarily fatal to the parties' agreement to arbitrate. Rather, numerous courts have focused on whether the forum selection is "integral" to the agreement such that "the unavailability of that arbitrator [brings] the agreement, to an end." If the arbitration forum is not deemed integral, courts have appointed a substitute arbitrator pursuant to § 5 of the FAA. If, however, contractual language establishes that the forum choice was integral, courts have not required arbitration by a substitute forum. Here, the district court concluded that the designation of NAF was integral to the parties' agreement and that the arbitration provision was rendered unenforceable due to NAF's unavailability. The court relied on the word "exclusively" in the NAF arbitration clause, and the fact that no provision was made for an alternate arbitrator. The Third Circuit reversed. The Third Circuit reasoned that the arbitration clause was ambiguous because it was unclear whether the word "exclusively" referred to the choice of NAF as a forum, or to arbitration in general, as the exclusive means of dispute resolution. The Third Circuit also noted that the arbitration provision incorporated the FAA,

suggesting that the FAA's procedures for appointing a substitute arbitrator should apply in the event of NAF unavailability.

Dell is noteworthy for several reasons. First, the questions of whether, and under what circumstances, a court may appoint a substitute arbitrator is one upon which courts disagree. Courts that have addressed this issue (including two cases involving identical NAF arbitration clauses) have reached conflicting conclusions. Second, the decision illustrates the strong federal policy of enforcing arbitration agreements pursuant to the FAA. Finally, and perhaps most significantly, *Dell* appears to place a high burden on contract drafters for establishing that a particular forum designation is "integral," such that its unavailability renders the provision unenforceable. Here, despite (1) use of the term "exclusively" with respect to arbitration before the NAF, (2) incorporation of the NAF's rules in the parties' arbitration agreement, and (3) the absence of language designating an alternate forum, the Third Circuit nonetheless found the arbitration provision ambiguous.

Another Federal Court Relegates Issue of Consolidation to Arbitration Panel

In our January 2012 Alert, we summarized a Seventh Circuit decision holding that the question of whether multiple arbitrations should be consolidated into a single proceeding must be decided by an arbitration panel, rather than a court. *See Blue Cross Blue Shield of Mass. v. BCS Ins. Co.*, 2011 WL 6382203 (7th Cir. Dec. 16, 2011). In a recent decision, a federal court in North Carolina reached the same conclusion under Fourth Circuit precedent. *Arrowood Indem. Co. v. Harper Ins. Co.*, 2012 WL 161667 (W.D.N.C. Jan. 19, 2012). In *Arrowood*, three separate disputes arose in connection with a reinsurance treaty. The parties agreed that all three disputes were subject to arbitration, but disagreed as to whether the three pending arbitrations should be consolidated. The court concluded that the issue was procedural in nature, and thus must be decided by the arbitration panel.

Ruling on a related issue, the court declined to appoint a neutral arbitrator in two of the arbitration panels, as petitioned by one of the parties. The court reasoned that if it impaneled arbitrators in the two incomplete panels, it would, in essence, constitute an implicit decision that the three arbitrations should be kept separate. Therefore, the court held, the third (and already completely impaneled) arbitration panel was the proper body to decide whether the disputes should be heard by a single panel or by three separate panels.

Expert Alert:
Kentucky Court Allows Expert to Opine as to Unreasonableness of Insurance Company's Settlement Offer, But Not as to Insurer Bad Faith

A federal court in Kentucky issued a mixed evidentiary ruling in a first party automobile insurance dispute, holding that a policyholder's expert was permitted to testify as to what the insurance company's initial settlement offer should have been, but was not permitted to state that the insurance company acted in bad faith. *Nevels v. Deerbrook Ins. Co.*, 2011 WL 6304066 (E.D. Ky. Dec. 16, 2011). Applying Rule 702 of the Federal Rules of Evidence, the court held that expert testimony regarding the propriety (or lack thereof) of the initial settlement offer was admissible because plaintiff had established that the expert was qualified to testify on this issue and that his testimony was reliable and relevant. However, the expert was not permitted to testify (1) that the insurance company acted in bad faith, or (2) what a local jury would have awarded the plaintiff. As to those two issues, the court found that the expert lacked a factual basis and the necessary qualifications for such opinions. In particular, the

court concluded that the expert did not have sufficient experience with jury verdicts in the geographic region upon which to base a jury verdict estimate, and did not adequately understand the standards for bad faith under Kentucky law.

The admissibility of expert testimony is an issue that frequently arises in bad faith insurance actions. Policyholders (and sometimes insurers) may seek to use expert testimony to establish the (un)reasonableness of the insurer's conduct. In numerous cases, courts have declined to consider such expert testimony, reasoning that the issue of bad faith is a legal concept which does not require scientific or technical knowledge, and that expert testimony as to the presence or absence of bad faith would improperly invade the fact-finding duties of a judge or jury. *See Lockhart v. State Farm Mut. Auto. Ins. Co.*, 2011 WL 395952 (3d Cir. Feb. 8, 2011); *Tracey v. Am. Family Mut. Ins. Co.*, 2010 WL 3724896 (D. Nev. Sept. 17, 2010); *Imperial Trading Co., Inc. v. Travelers Prop. Cas. Co. of Am.*, 654 F. Supp. 2d 518, 520-21 (E.D. La. 2009) (citing cases); *Med. Protective Co. v. Wiles*, 2011 WL 2420011 (Ky. Ct. App. Oct. 21, 2011). Courts have also rejected bad faith-related expert testimony on the basis of irrelevance and/or unreliability. *See Seto v. State Farm Ins. Co.*, 2012 WL 90431, at *6 n.4 (W.D. Pa. Jan. 11, 2012); *Hauff v. Petterson*, 755 F. Supp. 2d 1138, 1148 (D.N.M. 2010). However, where a bad faith action presents complex or unique issues unfamiliar to a layperson, expert testimony is more likely to be admissible, so long as it does not offer legal conclusions. *See Huey v. Super Fresh/Sav-A-Center, Inc.*, 2009 WL 604914, at *2 (E.D. La. Mar. 9, 2009).

Climate Change Alert:
Virginia Supreme Court Agrees to Rehear Coverage Dispute Over Global Warming Claims

Our October 2011 Alert highlighted a Virginia Supreme Court decision holding that an insurer did not owe defense or indemnity under comprehensive general liability policies for global warming-related claims because the underlying complaint did not allege an "occurrence." *AES Corp. v. Steadfast Ins. Co.*, 282 Va. 252 (2011). On January 17, 2012, the Virginia Supreme Court granted a motion to rehear the matter. Oral argument is scheduled for the February 2012 court session. We will continue to monitor this case and keep you apprised of any developments.

STB News Alerts:

On February 16, Bryce Friedman will be speaking at a New York City Bar program entitled, "Preserving Privileges: Ethical Issues Confronting Insurers, Policyholders & Counsel." The event will feature discussions on complex privilege issues that arise in insurance-related litigation. For more information about the program or to register, please click here.

On February 23, Andy Frankel and Mary Kay Vyskocil will speak at Perrin Conference's "Emerging Insurance Coverage & Allocation Issues in 2012" program in New York City. Andy will be speaking on a panel entitled "Asbestos Bankruptcy & Insolvencies: Recent Developments," addressing recent developments in asbestos-related bankruptcy cases, attempts to access insurance coverage issued to insolvent and dissolved policyholders outside the bankruptcy context and other related topics. Mary Kay will be speaking on a panel entitled "The Latest on Reinsurance Litigation, Arbitration and Risk Management," addressing updates on current case law, arbitration framework, structuring settlements and captive disputes. For more information about the program or to register, please click here.

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—Chambers USA 2010, Litigation: New York (quoting a client)

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