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INSURANCE LAW ALERT
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Welcome to the inaugural Simpson Thacher Insurance Law Alert. This Alert and the editions to follow aim to provide timely reports on insurance law and litigation developments of interest to our friends and clients. We hope you find them useful.

—Barry R. Ostrager, Chair of the Litigation Department

Allocation Alert:

Delaware Chancery Court Rules That New York Law Requires "All Sums" Method Of Allocation

On October 14, 2009, Vice Chancellor Strine of the Delaware Court of Chancery issued a lengthy opinion on allocation under New York insurance law. In a surprising departure from what is viewed to be well-established New York law, the court held that coverage for asbestos-related injuries spanning multiple policy years should be allocated on an "all sums" basis, rather than on a "pro rata" basis. *See Viking Pump, Inc. v. Century Indemnity Co.*, No. Civ. A. 1465-VCS, 2009 WL 3297559 (Del. Ch. Oct. 14, 2009). According to the Delaware court, under the all sums theory "a policy is responsible for all liability that flowed from a covered occurrence. In other words, any policy that covered part of a Multi-Period Exposure is responsible—up to its policy limits—for all of the liability that resulted from the exposure as a whole." Under the pro rata theory "any given insurer … is only responsible for some 'pro rata' share of the liability the insured owes to an asbestos plaintiff who suffered compensable harm as a result of a Multi-Period Exposure."

In 1985, Warren Pumps LLC and Viking Pump, Inc. acquired various pump manufacturing businesses from Houdaille Industries, Inc. Thereafter, Warren and Viking faced numerous asbestos bodily injury claims arising from asbestos exposures that took place during Houdaille's ownership. Warren and Viking sought to access Houdaille's insurance coverage, including forty-five excess insurance policies issued by twenty different insurers. After determining that Warren and Viking were entitled to insured status under Houdaille's excess insurance policies, the court turned to the allocation issue.

The excess insurers argued that controlling New York precedent requires a pro rata allocation across policy years, as set forth in the *Consol. Edison v. Allstate Ins. Co.*, 774 N.E.2d 687 (N.Y. 2002) decision from New York's highest court. The insureds argued for an "all sums" approach. Vice Chancellor Strine ultimately decided that New York's principles of contract interpretation, the language of the insurance policies at issue, and extrinsic evidence all favor application of the all sums allocation methodology. He criticized a number of federal court decisions applying New York law, stating:

> In those decisions, rather than using the well-accepted New York rule that doubts about coverage should be resolved against the insurer and in favor of the insured, federal courts have resolved ambiguities in

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> favor of the approach the court believed was most consistent with good "public policy" and "equit[y]." Largely devoid from those decisions was any rooting of these policy predilections in New York statutory law or decisions of the New York state courts. Rather, these decisions involve a free-wheeling consideration of what New York policy should be, in a manner that is rather surprising given the *Erie* doctrine. This is not to say that these decisions do not make well-reasoned arguments on one side of a controverted legal policy matter, it is simply to say that my role is to apply New York law in the manner most faithful to the teachings of its own courts.

Vice Chancellor Strine articulated the competing policy considerations as follows:

> Courts more concerned with guaranteeing full compensation to tort plaintiffs and holding insurers accountable up to the full policy limits when a policy is triggered, tend to favor the all sums method. By contrast, other courts have thought it unfair to hold a particular insurer fully responsible for an asbestos judgment against its insured when that insurer only had the coverage for, say, a year of the exposure period. These courts have tended to favor the pro rata approach.

Vice Chancellor Strine interpreted *Consol. Edison*'s "terse reasoning" to mean that the New York Court of Appeals did not intend to establish a bright-line rule on allocation. While purporting not to "quibble with the ultimate holding" in *Consol. Edison*, the court described the analysis as "extremely abbreviated and, at least to this mind, hardly compelled" by the policy language. The court declared that New York's Court of Appeals has not committed to a blanket position on allocation, but rather looks to the policy language at issue to effectuate the agreement of the parties. In *Consol. Edison*, the court based its pro rata allocation ruling on policy language limiting coverage to occurrences happening "during the policy period." Vice Chancellor Strine distinguished his case from *Consol. Edison* based on policy language. He found that unlike the policies at issue in *Consol. Edison*, the ones before him contained either "non-cumulation" or "prior insurance" provisions, or both, and that the policies' non-cumulation or prior insurance provisions could not "sensibly be applied within a pro rata allocation scheme."

Viking Pump is a potentially significant development for insurers operating under New York law. It ignores what was thought to be settled New York allocation law. Under the "all sums" approach applied by the Delaware court, policyholders can designate a single policy year to bear the responsibility for a covered loss that spans multiple policy periods. Insurers must then seek reimbursement from other insurers and bear any insurer insolvencies or uninsured periods of time. All else being equal, Delaware may become a desirable location to litigate allocation for policyholders with policies written out of New York.

Arbitration Alert:

Treaty Trumps State Law Restricting Arbitration In Insurance Contracts, Says Fifth Circuit In En Banc Opinion

On November 9, 2009, the en banc U.S. Court of Appeals for the Fifth Circuit ruled that an arbitration provision in an international reinsurance contract is enforceable notwithstanding a Louisiana statute that had been previously interpreted as prohibiting arbitration agreements in insurance contracts. *Safety National Casualty Corp. v. Certain Underwriters at Lloyd's, London*, No. 06-30262 (5th Cir. Nov. 9, 2009). In doing so, the court specifically disagreed with the Second Circuit opinion in *Stephens v. American Int'l Ins. Co.*, 66 F.3d 41 (2d Cir. 1995), creating a Circuit split on the issue of whether the Convention on the Recognition and Enforcement

of Foreign Arbitral Awards ("Convention") or its implementing statute is the relevant source to consider for purposes of determining whether a state law can invalidate an arbitration provision in an international agreement under the McCarran Ferguson Act.

In *Safety National Casualty Corp.*, underwriters provided reinsurance for excess policies issued to a Louisiana workers compensation self-insurance fund known as the Louisiana Safety Association of Timbermen—Self Insurers Fund (LSAT). After underwriters refused to recognize an assignment of the LSAT's rights to Safety National, LSAT brought suit in a Louisiana federal court. Underwriters moved to compel arbitration, arguing that it was required under the Convention. The Convention, an international treaty, requires that courts of signatory states "shall, at the request of one of the parties, refer the parties to arbitration…". LSAT contended that a Louisiana statute barring mandatory arbitration provisions in insurance contracts reverse-preempted the Convention under the McCarran-Ferguson Act, which provides that no act of Congress is to be construed to invalidate, impair or supersede a state insurance law unless the act of Congress specifically relates to the business of insurance. The district court ultimately denied the motion, finding that the McCarran-Ferguson Act allowed a Louisiana statute forbidding arbitration provisions in insurance contracts to "reverse-preempt" the Convention and its implementing legislation, the Convention Act.

The Fifth Circuit reversed, holding that the term "act of Congress" as used in the McCarran-Ferguson Act did not encompass international treaties such as the Convention regardless of whether the treaty was self-executing or required implementing legislation. This holding was contrary to the Second Circuit decision in *Stephens*, where the court found that the implementing statute, rather than the Convention itself, was the relevant consideration and that state law could invalidate an arbitration provision in an international agreement.

The Fifth Circuit opinion provides substantial ammunition for non-U.S. insurers and reinsurers seeking to enforce arbitration provisions in the face of hostile state law.

Appellate Alert:

New York's Highest Court Refuses To Hear Keasbey Appeal

On October 27, 2009, the New York Court of Appeals denied motions for leave to appeal filed by Michael P. O'Reilly and Employers Liability Assurance Company with respect to the New York Appellate Division, First Department's decision in *Continental Casualty Company v. Employers Insurance Company of Wausau*, Index No. 601037/03 (N.Y. App. Div., First Dept., Dec. 30, 2008). The First Department *Keasbey* decision reversed a May 2007 trial court ruling that had threatened to expand the scope of insurance coverage available for asbestos personal injury claims allegedly arising out of policyholders' operations. The claims involved Robert A. Keasbey Company, a defunct insulation contractor that installed, repaired, renovated and removed insulation at various sites around New York. The First Department decision, which is now final, reached a number of conclusions significant to insurers, including:

Burden of Proving Operations Coverage. The First Department held that claimants who bring direct action lawsuits stand in the shoes of defunct policyholders and therefore bear the burden of proving their entitlement to coverage, including the burden of showing that actual injury occurred in the policy period and that such injury arose solely out of an ongoing operation.

Equitable Defenses. Citing New York Insurance Law § 3420, which permits third parties to bring coverage claims directly against insurers in certain circumstances, the First Department explained that "all

the defenses available to an insurer against an insured are available also against injured claimants." The court specifically held that affirmative defenses, such as laches, estoppel and waiver, were valid affirmative defenses against the claimants, who were standing in the shoes of Keasbey, a defunct policyholder, and reversed the trial court's ruling that it would be inequitable to apply such defenses to the individual claimants.

Trigger of Coverage. The First Department rejected the trial court's ruling that coverage under an insurer's primary policy is triggered by exposure to asbestos during inhalation. Citing the New York Court of Appeals' decision in *Continental Casualty Co. v. Rapid American Corp.*, the Court recognized that *injury-in-fact* is the appropriate coverage trigger under New York law, and that the claimants' failure to offer evidence that any of them sustained actual injury in fact during the policy periods before the policyholder's operations were completed was fatal to their claim for "operations" coverage. The court rejected the trial court's reliance on *Frontier Insulations Contrs. v. Merchants Mut. Ins. Co.* on numerous grounds, including because *Frontier Insulations* involved the duty to defend, which is broader than the duty to indemnify, the absence of evidence in that case as to when injury occurred, and the fact that applying a presumption of injury upon inhalation was inconsistent with the evidence presented and policy language. The First Department also observed that pinpointing the date of injury is "especially crucial" in an operations coverage case, because injury must be shown to arise before the completion of an operation. Based on evidence submitted during trial, the court concluded that "it can take 20 to 40 years after exposure for actual impairment of bodily functions to develop" and held that none of the claimants could establish that any actual injury triggered coverage under any of the subject policies:

> The claimants are making an impermissible leap if they believe they can go forward and prove injury during ongoing operations simply by a conclusory assertion: claimant was exposed, claimant developed full blown asbestos-related injury decades later, ergo, injury was sustained at time of exposure… In order for claimants to establish their entitlement to limitless liability and perpetual coverage they must show, under the relevant provisions of the subject policies, **that the actual injury occurred in the policy period and that it arose solely out of an ongoing operation.** (Emphasis added.)

In short, the court clarified that so-called operations coverage is triggered only by actual injury that occurs during the policy period and during the period of an ongoing operation—a ruling that is consistent with the leading decision in *Wallace & Gale*. *See Aetna Casualty & Surety Co. v. The Wallace & Gale Co.*, 275 B.R. 223, 238 (D. Md. 2002), aff'd, *In re: Wallace & Gale Co.,* 385 F. 3d 820 (4th Cir. 2004).

Verdict Alert:

Connecticut Auto Repair Shops Awarded $15 Million Against Insurer Over Appraisals

On November 17, 2009, a Connecticut jury in Stamford Superior Court awarded $15 million to automobile repair shop owners in their lawsuit accusing an affiliate of The Hartford Financial Services Group of unfair trade practices. For six years, the Auto Body Association of Connecticut has claimed that the insurer's labor rates for repair of their insureds' automobiles were artificially low because the insurer largely eliminated the use of independent appraisers in favor of the insurers' own appraisers. The jury appears to have agreed. But, the jury also seems to have recognized that Hartford's use of a network of "preferred" auto repair shops was in compliance with Connecticut law and insureds were not improperly "steered" to those shops by the insurer. An appeal is anticipated.

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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The firm’s leading status in the insurance arena is undisputed. It works on some of the biggest insurance and reinsurance litigation and arbitration matters around and is acknowledged by competitors to be a ‘formidable adversary.’

—Chambers USA 2009

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