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INSURANCE LAW ALERT

MAY 2014

This Alert highlights decisions addressing the exhaustion requirement for excess coverage and an insurer's right to contribution of defense and indemnity costs from other insurers. In addition, we report on rulings enforcing policy exclusions relating to pollution, Telephone Consumer Protection Act claims and unknown progressive property damage. Finally, we report on two recent discovery rulings pertaining to privilege and the relevance of loss reserve estimates in a bad faith action. Please "click through" to view articles of interest.

- ***Excess Coverage Contingent Upon Primary Insurer Payment of Full Policy Limits, Says Texas Court***

  A Texas federal district court ruled that applicable policy language required actual payment of full policy limits by the primary insurer in order to implicate excess coverage. *Martin Resource Mgmt. Corp. v. Zurich American Ins. Co.*, No. 6:12-CV-758 (E.D. Tex. May 12, 2014). *(click here for full article)*

- ***Illinois Appellate Court Rules That TCPA Exclusion Eliminates Insurer's Duty To Defend***

  An Illinois appellate court ruled that an insurer had no duty to defend based on a policy exclusion relating to violations of the Telephone Consumer Protection Act. *G.M. Sign, Inc. v. State Farm Fire & Casualty Co.*, No. 2-13-0593 (Ill. Ct. App. May 2, 2014). *(click here for full article)*

- ***Eighth Circuit Rules That Floor Sealant Vapors Constitute a "Pollutant"***

  The Eighth Circuit ruled that concrete sealant fumes unambiguously fell within the definition of "pollutant" in a pollution exclusion. *United Fire & Casualty Co. v. Titan Contractors Service, Inc.*, 2014 WL 1887365 (8th Cir. May 13, 2014). *(click here for full article)*

- ***South Dakota Supreme Court Enforces Exclusion Barring Coverage for Unknown Continuous Damage***

  The South Dakota Supreme Court ruled that a policy exclusion that bars coverage for unknown progressive or continuous injury or damage that occurred before the policy inception date is enforceable and does not violate public policy. *AMCO Ins. Co. v. Employers Mutual Casualty Co.*, 2014 WL 1512423 (S.D. Apr. 16, 2014). *(click here for full article)*

- ***Bankruptcy Code Does Not Permit Excess Insurer to Challenge Settlement Between Policyholder/Debtor and Primary Insurer, Says Seventh Circuit***

  The Seventh Circuit denied an excess insurer's request to intervene in bankruptcy proceedings in order to challenge a settlement between the policyholder/debtor and an insolvent primary insurer. *In re C.P. Hall Co.*, 2014 WL 1628119 (7th Cir. Apr. 24, 2014). *(click here for full article)*

- ***Illinois Appellate Court Rules That Contribution Claim is Barred by "Targeted Tender" Doctrine***

  An Illinois appellate court ruled that an insurer that has been targeted by the policyholder to provide a defense may not seek contribution from another insurer whose policy might also provide coverage. *AMCO Ins. Co. v. Cincinnati Ins. Co.*, 2014 Ill. App.(1st) 122856 (Ill. App. Ct. May 5, 2014). *(click here for full article)*

- ***Nebraska Supreme Court Allows Equitable Contribution Claim Where Policies Insure the Same Risk***

  The Nebraska Supreme Court ruled that an insurer is entitled to contribution from another insurer where both policies insure the same entities, the same interest in the same property, and the same risk—even if the policies do not provide identical coverage in all respects. *American Family Mutual Ins. Co. v. Regent Ins. Co.*, 288 Neb. 25 (Neb. May 2, 2014). *(click here for full article)*

- ***Third Circuit Rules That Loss Reserve Estimates Are Not Discoverable in Bad Faith Action***

  The Third Circuit ruled that an insurer's loss reserve estimates were not discoverable because they were not relevant to whether an insurer acted in bad faith during settlement negotiations. *Mirachi v. Seneca Specialty Ins. Co.*, 2014 WL 1673748 (3d Cir. Apr. 29, 2014). *(click here for full article)*

- ***California Court Outlines Scope of "Common Interest" Doctrine in Coverage Dispute***

  A California federal district court outlined the standards for establishing a "common interest" such that the sharing of privileged documents does not result in a waiver of privilege. *Lennar Mare Island, LLC v. Steadfast Ins. Co.*, 2014 WL 1366252 (E.D. Cal. Apr. 7, 2014). *(click here for full article)*

Excess Coverage Alert:

Excess Coverage Contingent Upon Primary Insurer Payment of Full Policy Limits, Says Texas Court

Previous Alerts have discussed whether excess coverage is available when a policyholder has settled with a primary insurer for an amount less than primary policy limits. *See* June 2013 Alert; October 2012 Alert; September and October 2011 Alerts. In a recent decision, a Texas federal district court followed what appears to be an emerging trend, ruling that applicable

policy language required actual payment of full policy limits by the primary insurer in order to implicate excess coverage. *Martin Resource Mgmt. Corp. v. Zurich American Ins. Co.*, No. 6:12-CV-758 (E.D. Tex. May 12, 2014).

The policyholder sought excess coverage from AXIS Insurance Company following a below-limits settlement with its primary insurer. In ensuing litigation, the court granted AXIS's summary judgment motion, finding that excess coverage was conditioned upon the primary insurer's actual payment of full policy limits. The operative policy provision stated that excess coverage applied only "after all applicable Underlying Insurance … has been exhausted by actual payment under such Underlying Insurance …." The court reasoned that this language, when read in conjunction with other clauses referring to "actual payment under the Underlying Insurance" unambiguously required full payment by the primary insurer. The court cited to the Fifth Circuit's ruling in *Citigroup Inc. v. Federal Ins. Co.*, 649 F.3d 367 (5th Cir. 2011) (discussed in September 2011 Alert), which reached the same result. The court rejected the policyholder's argument that prohibiting the policyholder from accessing excess coverage would violate Texas's public policy in favor of settlements, explaining that public policy considerations do not override unambiguous contract terms.

Coverage Alerts:

Illinois Appellate Court Rules That TCPA Exclusion Eliminates Insurer's Duty To Defend

Reversing a trial court decision, an Illinois appellate court ruled that a policy exclusion relating to violations of the Telephone Consumer Protection Act ("TCPA") barred coverage for all claims against the policyholder and thus that the insurer had no duty to defend the underlying suit. *G.M. Sign, Inc. v. State Farm Fire & Casualty Co.*, No. 2-13-0593 (Ill. Ct. App. May 2, 2014).

The policy exclusion at issue barred coverage for damage or injury "arising directly or indirectly" out of any act that violates or allegedly violates the TCPA or

This edition of the Insurance Law Alert was prepared by Mary Beth Forshaw (mforshaw@stblaw.com/212-455-2846) and Bryce L. Friedman (bfriedman@stblaw.com/212-455-2235) with contributions by Karen Cestari (kcestari@stblaw.com).

any other similar statute. The policyholder argued that this exclusion was specific to TCPA claims and thus did not bar coverage for claims alleging conversion and consumer fraud, which have different elements and potential damage recoveries than a TCPA cause of action. The appellate court disagreed, explaining that because the conversion and fraud claims would not exist "but for" the TCPA violations, they were encompassed by the exclusion regardless of whether they were premised on different facts and different legal elements. In so ruling, the court rejected a Missouri federal district court opinion that reached the opposite conclusion in the face of a similar policy exclusion.

Eighth Circuit Rules That Floor Sealant Vapors Constitute a "Pollutant"

Claimants sued a construction clean-up company for injuries sustained as a result of exposure to concrete sealant fumes. Thereafter, the company's general liability insurer sought a declaration that it had no duty to defend or indemnify the suit based on an absolute pollution exclusion. Both parties moved for summary judgment, and a Missouri federal district court ruled in favor of the policyholder on the basis that the sealant did not constitute a "pollutant." The Eighth Circuit vacated the ruling, finding that the sealant unambiguously

fell within the definition of "pollutant" because of its irritant-qualities. *United Fire & Casualty Co. v. Titan Contractors Service, Inc.*, 2014 WL 1887365 (8th Cir. May 13, 2014).

The decision is significant in several respects. First, the court held that, where a statute classifies the substance as a "pollutant," the policyholder should be on notice that injuries caused by that substance might trigger the pollution exclusion. Other courts have issued conflicting analyses as to whether classification of a substance as a "pollutant" by the Clean Air Act or other statutory law is relevant to the pollution exclusion analysis. Second, the court distinguished and narrowly construed *Hocker Oil Co. v. Barker-Phillips-Jackson, Inc.*, 997 S.W.2d 510 (Mo. Ct. App. 1999), a decision frequently cited by policyholders arguing against the application of a pollution exclusion. The *Hocker* court deemed a pollution exclusion ambiguous as to damages caused by a gasoline leak, primarily on the basis that "it would be an oddity for an insurance company to sell a liability policy to a gas station that would specifically exclude that insured's major source of liability." The Eighth Circuit noted that *Hocker* represents a "minority position [that] has almost uniformly been rejected by appellate courts in other jurisdictions" and constitutes a departure from the basic tenets of contract interpretation. The Eighth Circuit further ruled that even if *Hocker* reflected Missouri law, it was inapplicable because the policyholder's business created a "wide

range of liability risks unrelated to [the floor sealant]." Therefore, the court vacated the district court's decision and remanded the matter for a factual determination of whether the underlying claims alleged the "discharge, dispersal, seepage, migration, release or escape" of the sealant.

South Dakota Supreme Court Enforces Exclusion Barring Coverage for Unknown Continuous Damage

Addressing a matter of first impression, the South Dakota Supreme Court ruled that a policy exclusion that bars coverage for unknown progressive or continuous injury or damage that occurred before the policy inception date is enforceable and does not violate public policy. *AMCO Ins. Co. v. Employers Mutual Casualty Co.*, 2014 WL 1512423 (S.D. Apr. 16, 2014).

Thomas & Sons performed excavation work at a school in 2004. In 2005 and 2006, cracking and floor shifting became apparent. In 2008, the school hired a firm to investigate the problems, and a final report was issued two years later. The report attributed the problems to negligent excavation work by Thomas & Sons. Thereafter, a lawsuit was filed against Thomas & Sons. Employers Mutual, its general liability insurer, refused to defend on several bases, including a policy exclusion for continuous unknown property damage that occurred before the policy's 2007 inception date. AMCO, who also provided insurance to Thomas & Sons, sued Employers for contribution to defense and indemnification costs. AMCO argued that the policy exclusion was void as against public policy and "antithetical to the nature of insurance," the purpose of which is to protect against loss from unknown events. The court disagreed and granted Employers' summary judgment motion.

The South Dakota Supreme Court held that the exclusion was unambiguous and applied squarely to the facts presented. In declining to void the exclusion on public policy grounds, the court noted the absence of any state law, decision or administrative ruling specifically addressing this issue. Additionally, the court emphasized the parties' right to negotiate and enforce private contract terms. However, the court suggested that a different result might be reached in jurisdictions in which state statutory law establishes a clear public policy relating to insurance coverage for unknown losses. *See, e.g.*, Colorado Rev. Stat. 10-4-110.4 (declaring void and unenforceable commercial general liability policy exclusions that bar coverage for unknown preexisting injury or damage).

BANKRUPTCY ALERT:

Bankruptcy Code Does Not Permit Excess Insurer to Challenge Settlement Between Policyholder/ Debtor and Primary Insurer, Says Seventh Circuit

The Seventh Circuit denied an excess insurer's request to intervene in bankruptcy proceedings in order to challenge a settlement between the policyholder/ debtor and an insolvent primary insurer. *In re C.P. Hall Co.*, 2014 WL 1628119 (7th Cir. Apr. 24, 2014).

Hall, a former distributor of asbestos products, declared bankruptcy. At the time of its bankruptcy filing, Hall had $10 million of remaining primary insurance coverage available from an insurer which was insolvent. Hall and the primary insurer agreed to

settle for $4.125 million. Columbia Casualty, an excess insurer, objected to the settlement because it greatly "increased the likelihood of Columbia's having to honor its secondary-coverage obligation." The bankruptcy court refused to consider the objection. Columbia Casualty appealed, and the Seventh Circuit affirmed.

The Seventh Circuit held that in order to become a party to the bankruptcy proceeding, Columbia Casualty would have to establish that a "legislatively conferred cause of action encompasses its claim." More specifically, Columbia Casualty must prove that it is a "party in interest," or an entity with a legally recognized interest in the debtor's assets. The court concluded that Columbia Casualty did not meet this standard because it was not a "creditor" or a "guardian of conduct" but rather "just a firm that may suffer collateral damage from a ruling in a bankruptcy proceeding." In so ruling, the court distinguished two recent decisions in which courts allowed insurers to intervene in bankruptcy proceedings on the basis that the insurers' contractual rights and obligations were improperly altered and/ or threatened by the terms of the debtors' proposed settlements . *See In re Global Industrial Technologies, Inc.*, 645 F.3d 201 (3d Cir. 2011) (discussed in December 2011 Alert); *In re Thorpe Insulation Co.*, 677 F.3d 869 (9th Cir. 2012) (discussed in February 2012 Alert). The court also stressed the importance of excess policy language in this context, noting that excess insurers can take protective measures such as including policy language that requires the full payment of primary policy limits prior to obtaining excess coverage.

CONTRIBUTION ALERTS:

An insurer which seeks reimbursement for defense or indemnity costs from another insurer typically invokes principles of equitable contribution or subrogation. As two recent decisions illustrate, these doctrines provide distinct legal bases for reimbursement.

Illinois Appellate Court Rules That Contribution Claim is Barred by "Targeted Tender" Doctrine

Relying on principles of subrogation, an Illinois appellate court ruled that an insurer that has been targeted by the policyholder to provide a defense may not seek contribution from another insurer whose policy might also provide coverage. *AMCO Ins. Co. v. Cincinnati Ins. Co.*, 2014 Ill. App.(1st) 122856 (Ill. App. Ct. May 5, 2014).

An injured worker sued a construction company and several sub-contractors, each of whom was insured under a different general liability policy. The construction company did not seek a defense from its own general liability insurer (Cincinnati Insurance Company), opting to tender defense of the lawsuit to AMCO Insurance Company and Erie Insurance Company, both of which provided "additional insured"

coverage to the construction company. AMCO accepted tender subject to a reservation of rights and ultimately reached a settlement with the claimant. Pursuant to the settlement, AMCO was assigned all rights and claims against Erie and Cincinnati. AMCO filed a declaratory judgment action against the two insurers and Cincinnati moved to dismiss. The trial court granted Cincinnati's motion, ruling that the "targeted tender" doctrine prevents an insurer that has been selected by the policyholder to provide a defense from seeking contribution from non-targeted insurers. The appellate court affirmed.

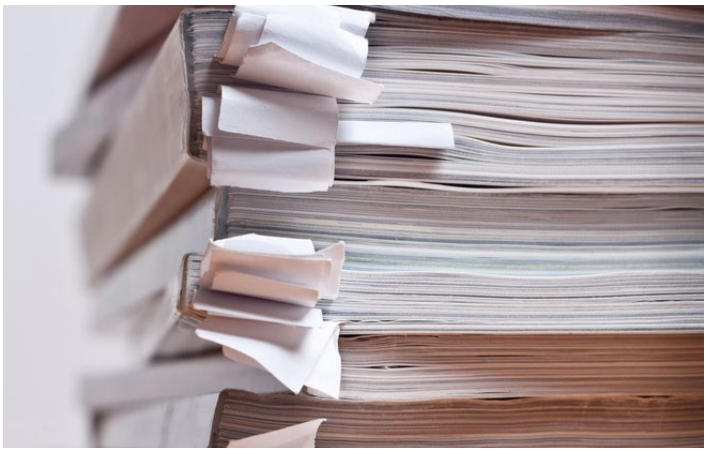
The appellate court agreed with Cincinnati that the right to target an insurer ends with resolution of the underlying claim. Thus, once AMCO settled the suit, any opportunity to target Cincinnati, or to "deselect" AMCO as the targeted insurer, had expired. In so ruling, the court rejected AMCO's argument that because it was assigned all rights against Cincinnati, AMCO possessed the right to deselect itself as the targeted insurer and instead select Cincinnati.

Illinois is one of a small handful of states to follow the "targeted tender" doctrine. Illinois courts have limited its scope in recent years. In particular, the doctrine does not apply where a policyholder attempts to target excess policies before exhausting primary policies and where policies provide coverage consecutively rather than concurrently.

Nebraska Supreme Court Allows Equitable Contribution Claim Where Policies Insure the Same Risk

The Nebraska Supreme Court ruled that an insurer is entitled to contribution from another insurer where both policies insure the same entities, the same interest in the same property, and the same risk—even if the policies do not provide identical coverage in all respects. *American Family Mutual Ins. Co. v. Regent Ins. Co.*, 288 Neb. 25 (Neb. May 2, 2014).

The contribution action arose from a personal injury suit against an apartment complex owner (Beacon Hill) and its management company (Dodge Management). Both entities were insured under primary and umbrella policies. American Family Mutual Insurance Company issued Beacon Hill's policies and Regent Insurance Company issued Dodge Management's policies. Both primary policies named the other party as an additional insured. American Family defended both parties and



ultimately reached a settlement. Although Regent conceded that the settlement was "fair and reasonable," it refused to contribute. After American Family sued Regent for equitable contribution, the parties cross-moved for summary judgment. The district court granted American Family's motion and the Nebraska Supreme Court affirmed.

The Nebraska Supreme Court ruled that an equitable right to contribution exists when (1) an insurer of a joint tortfeasor has paid all, or more than its fair share, of a loss, or (2) when a policyholder is covered by concurrent policies and one insurer has paid all, or more than its fair share, of a loss. Under the latter scenario, contribution is proper when the policies insure the "same risk." The court concluded that, here, American Family and Regent insured the same risk even though the policies did not provide identical coverage in all respects. In particular, although Regent argued that its umbrella policy did not list Beacon Hill as an additional insured, and its primary policy limited coverage to Beacon Hill in several respects, the policies nonetheless covered the "same risk" for contribution purposes. In this respect, the court cited to several factors, including the policyholders' joint liability for the underlying claims and principles of equity. With respect to apportionment of the settlement, the court held that the two primary policies should respond (up to policy limits) before the two umbrella policies, and that pro rata allocation of umbrella coverage based on policy limits was appropriate.

Discovery Alerts:

Third Circuit Rules That Loss Reserve Estimates Are Not Discoverable in Bad Faith Action

Affirming a Pennsylvania district court decision, the Third Circuit ruled that an insurer's loss reserve estimates were not discoverable because they were not relevant to whether a property insurer acted in bad faith during settlement negotiations. *Mirachi v. Seneca Specialty Ins. Co.*, 2014 WL 1673748 (3d Cir. Apr. 29, 2014).

Seneca issued a property policy to Mirachi. Following a fire, Mirachi sought coverage for the actual cash value of the property. When the parties were unable to agree on the value of the property, they engaged in an appraisal process in which an umpire concluded that actual cash value of the property exceeded policy limits. Mirachi then sued Seneca, alleging bad faith delay in payment. A Pennsylvania federal district court denied Mirachi's request for discovery of Seneca's loss reserves and granted Seneca's summary judgment motion. The Third Circuit affirmed.

The Third Circuit explained that loss reserve estimates reflect only what the insurer "could be" required to pay and do not represent "an evaluation of coverage based upon a thorough factual and legal consideration." As such, the court deemed the reserves irrelevant to allegations that the insurer's settlement conduct constituted bad faith. In a footnote, the Third

Circuit also affirmed the district court's ruling that Seneca's communications with its reinsurer were not relevant to Seneca's claim evaluation.

California Court Outlines Scope of "Common Interest" Doctrine in Coverage Dispute

Ruling on a motion to compel discovery, a California federal district court outlined the standards for establishing a "common interest" such that the sharing of privileged documents does not result in a waiver of the privilege. *Lennar Mare Island, LLC v. Steadfast Ins. Co.*, 2014 WL 1366252 (E.D. Cal. Apr. 7, 2014).

The coverage dispute arose out of environmental contamination at Mare Island caused by U.S. Naval operations. The Navy closed its base and conveyed title to the City of Vallejo, which in turn conveyed title to a portion of the base to Lennar Mare Island, LLC ("LMI"). In connection with the transfers, the parties entered into agreements that allocated their respective remediation obligations. Thereafter, LMI sued Steadfast Insurance, seeking coverage for remediation costs. During discovery, Steadfast requested production of litigation-related communications between LMI and the Navy. LMI objected on the basis of attorney-client privilege and/or the work-product doctrine. LMI argued that it shared a "joint interest" with the Navy and the City of Vallejo that entitled it to share documents without waiving the underlying attorney-client privilege or work product immunity.

In addressing Steadfast's motion to compel, the court explained that a party seeking to withhold documents must establish the privileged status of those documents as a threshold matter. After that showing is made, the "common interest" doctrine comes into play. If a common interest is established, disclosure of privileged materials between parties with a joint interest will not constitute a waiver of the privilege. The court also found that, for purposes of preserving attorney-client privilege, the parties must share a common interest in securing legal advice related to the same matter and the communications must be made to advance the shared interest. A shared desire for the same outcome or "overlapping interests" is insufficient.

Ultimately, the court rejected LMI's argument that it shared a common interest with the Navy and the City of Vallejo by virtue of their mutual goal of obtaining insurance coverage from Steadfast. The court explained that neither the Navy nor the City was involved in litigation with Steadfast, or party to the insurance agreement between LMI and Steadfast. Thus, LMI failed to establish that the communications it shared with the Navy and the City were made in pursuit of a joint legal strategy.

The decision also addressed work-product immunity, finding it is preserved so long as there is a shared financial or commercial interest and a reasonable basis for believing that the common interest recipient will keep the disclosed material confidential. The court concluded that here, that work-product protection was maintained because LMI, the Navy and the City shared a financial interest in having Steadfast provide indemnification for remediation. The court also found that LMI had a reasonable basis to believe that the Navy and City would keep the disclosed materials confidential.

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.

Barry R. Ostrager
(212) 455-2655
bostrager@stblaw.com

Mary Kay Vyskocil
(212) 455-3093
mvyskocil@stblaw.com

Andrew S. Amer
(212) 455-2953
aamer@stblaw.com

David J. Woll
(212) 455-3136
dwoll@stblaw.com

Mary Beth Forshaw
(212) 455-2846
mforshaw@stblaw.com

Andrew T. Frankel
(212) 455-3073
afrankel@stblaw.com

Lynn K. Neuner
(212) 455-2696
lneuner@stblaw.com

Chet A. Kronenberg
(310) 407-7557
ckronenberg@stblaw.com

Linda H. Martin
(212) 455-7722
lmartin@stblaw.com

Bryce L. Friedman
(212) 455-2235
bfriedman@stblaw.com

Michael D. Kibler
(310) 407-7515
mkibler@stblaw.com

Michael J. Garvey
(212) 455-7358
mgarvey@stblaw.com

Tyler B. Robinson
+44-(0)20-7275-6118
trobinson@stblaw.com

George S. Wang
(212) 455-2228
gwang@stblaw.com

Deborah L. Stein
(310) 407-7525
dstein@stblaw.com

Craig S. Waldman
(212) 455-2881
cwaldman@stblaw.com

Elisa Alcabes
(212) 455-3133
ealcabes@stblaw.com

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UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
2 Houston Center
909 Fannin Street
Houston, TX 77010
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3919 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
West Tower, Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000