Simpson Thacher

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"The [Simpson Thacher] team is exceptional - their drafting is incredible and they are on top of every detail."

– *Chambers USA* 2024 (quoting a client)

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The Seventh Circuit ruled that the question of whether a previous arbitration award had preclusive effect over a current reinsurance dispute was itself subject to arbitration. *National Casualty Co. v. Continental Ins. Co.*, 2024 U.S. App. LEXIS 29826 (7th Cir. Nov. 22, 2024). (Click here for full article)

A California district court granted a reinsurer's motion to compel arbitration, rejecting the ceding insurer's assertion that the dispute related to a separate agreement between the parties that did not contain an arbitration clause. *Truck Ins. Exchange v. Certain Underwriters at Lloyd's London*, No. 2:24-cv-08157 (C.D. Cal. Nov. 15, 2024). (Click here for full article)

California Appellate Court Affirms Dismissal Of Coverage Suit Based On Abuse Or Molestation Exclusion

A California appellate court ruled that an abuse or molestation exclusion barred coverage for claims arising out of incidents at a massage spa because the victims were under the "care" and "control" of the spa during the alleged incidents, as required by the exclusion. *Gordon v. Continental Cas. Co.*, 2024 Cal. App. LEXIS 777 (Cal. Ct. App. Dec. 3, 2024). (Click here for full article)

Ohio Supreme Court Rules That Policyholder's Payments Into Lead Paint Abatement Fund Are Not Covered "Damages" Under Insurance Policies

HOLDING

The Ohio Supreme Court ruled that an insured's payments into an abatement fund established to mitigate the hazards of lead paint were not covered "damages" under applicable insurance policies. *Sherwin-Williams Co. v. Certain Underwriters at Lloyd's London*, 2024 Ohio LEXIS 2789 (Ohio Dec. 10, 2024).

BACKGROUND

The coverage dispute arose out of a lawsuit filed by Santa Clara County, California against Sherwin-Williams and other paint companies. The initial complaint asserted several causes of action, but the suit ultimately moved forward on a single public nuisance claim. The suit ended with a ruling against the paint companies that included an order to pay $1.15 billion (an amount that was later reduced to $409 million) into an abatement fund that would be used for paint testing in homes, remediation of lead paint-related hazards and education relating to lead paint poisoning, among other things. The paint companies ultimately agreed in July 2019 to a $305 million settlement.

Sherwin-Williams sued its insurers, seeking indemnification. The insurers moved for summary judgment on several bases, including that the policies covered only damages "for," "because of," or "on account of" property damage or bodily injury and that no such damages had been awarded against Sherwin-Williams.

An Ohio trial court ruled in the insurers' favor, holding that an abatement fund payment is distinguishable from a damages award in that the former constitutes an equitable, forward-looking remedy, whereas the latter provides compensation for past harm. The trial court therefore concluded that no "damages" had been awarded under the policies and that the insurers had no duty to indemnify.

An Ohio appellate court reversed, holding that Sherwin-Williams' payments to the abatement fund constituted damages, reasoning the fund was not only established to address future harms, but also to compensate the California government for money spent in ongoing efforts to remediate homes containing lead paint.

The Ohio Supreme Court reversed and reinstated the trial court's entry of summary judgment in favor of the insurers.

DECISION

The Ohio Supreme Court held that, under the language of the policies, payments to the abatement fund did not constitute covered "damages." Sherwin-Williams argued that the fund compensated for past harms because lead paint had been present in certain California homes for decades. Rejecting this assertion, the court emphasized that abatement is a remedy that "looks to prevent future harm" and, in any event, the order against the paint companies in the California suit clearly indicated that the purpose of the abatement fund was to prevent, or at a minimum mitigate, future risk of harm to children through inspections, remediation and education, rather than to compensate the government for past expenditures.

Sherwin-Williams also argued that, because it was held liable for nuisance arising out of lead paint in homes that were built decades ago, the purpose of abatement fund payments was to compensate for past "physical damage" to property. The court rejected this contention as well, emphasizing that the abatement payment was not ordered to compensate for past physical damage to buildings and instead focused on abating potential future harm to human beings.

COMMENTS

The decision highlights the parameters of the term "damages" for purposes of insurance indemnification, which may cover compensation for past harms but not an abatement fund payment to prevent future harms. Notably, the court expressly distinguished a decision involving "response costs" under the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") for environmental hazards, explaining that response costs in that case were aimed at remediating past harm done to property, notwithstanding that the suit alleged public nuisance.

Simpson Thacher represents Travelers in this matter.

Delaware Supreme Court Agrees To Review Self Insured Retention Ruling In 3M Earplug Coverage Dispute

HOLDING

The Delaware Supreme Court granted a motion for interlocutory review, finding that a lower court's ruling relating to whether a corporate parent's defense cost payments counted towards its wholly-owned subsidiaries' self insured retention ("SIR") addressed issues of material importance to the insurance coverage dispute. *Aearo Technologies LLC v. Ace American Ins. Co.*, No. 423, 2024 (Del. Dec. 2, 2024).

BACKGROUND

Aearo, a manufacturer and distributor of earplugs, was acquired by 3M in 2008. 3M continued to distribute the earplugs until 2015. Beginning in 2018, hundreds of thousands of claims were filed against Aearo and 3M, seeking damages for hearing-related injuries allegedly caused by the earplugs. The suits were consolidated into a multidistrict litigation ("MDL") and, in numerous trials that ensued, 3M faced verdicts of over $250 million. Aearo and 3M ultimately settled the underlying lawsuits for more than $6 billion.

In 2023, 3M and Aearo sued several insurers that had issued commercial general liability policies to Aearo, seeking coverage for defense costs as well as a settlement that was reached in the MDL. 3M and Aearo moved for partial summary judgment, arguing that five primary insurers were obligated to cover approximately $372 million that 3M paid in defenses costs and approximately $412,000 that Aearo paid in defense costs. In response, the insurers moved for partial summary judgment, arguing, among other things, that they

had no obligation to pay such costs because 3M was not an insured under the policies and because 3M's payments did not erode Aearo's $250,000 SIR under the policies.

DECISION

A Delaware trial court denied Aearo and 3M's motion and granted in part and denied in part the insurers' motion for partial summary judgment. The trial court ruled that, under four primary policies, defense costs paid by 3M did not count towards the SIR and that issues of fact existed as to whether Aearo's payment of defense costs exhausted the SIR. The court also held that issue of facts existed as to whether Aearo provided adequate notice to or obtained consent from the insurers before incurring defense costs.

As to the primary insurers' motion, the court ruled that coverage obligations must be decided on a case-by-case basis since the policies had different coverage periods and the suits named different defendants and alleged injuries at different times. The court concluded that issues of fact existed as to whether defense costs were jointly incurred by Aearo and 3M and how such costs should be allocated. The trial court granted one primary insurer's motion for partial summary judgment (Twin City), ruling that the single Aearo entity that was insured under that policy and had not paid any defense costs that satisfied the SIR.

In granting the petition for interlocutory review, the Delaware Supreme Court emphasized that the trial court's decision implicated "substantial issues of material importance" to the merits of the coverage dispute, including whether 3M's payments of defense costs count toward "its wholly owned subsidiaries' [Aearo's] self-insured retention."

COMMENTS

Because a key issue in this case relates to whether an insured's obligations under a policy can be satisfied by a payment from a corporate affiliate under Delaware law, the Delaware Supreme Court's ruling may speak to both issues of insurance coverage and corporate law. We will keep you posted on developments in this matter.

Ninth Circuit Rules That Insurer Had No Duty To Reimburse Costs Of Policyholder's Independent Counsel

HOLDING

The Ninth Circuit affirmed the dismissal of a policyholder's suit against her insurer seeking reimbursement of costs paid to independent counsel in an underlying defamation suit. *New York Marine and General Ins. Co. v. Heard*, 2024 U.S. App. LEXIS 29910 (9th Cir. Nov. 25, 2024).

BACKGROUND

The coverage dispute arose out of actor Johnny Depp's defamation suit against his former spouse, actress Amber Heard. Heard retained a Virginia law firm to defend the suit but did not notify her insurer, New York Marine, until approximately six months after the suit was filed. New York Marine agreed to defend subject to a reservation of rights and continued the appointment of the Virginia law firm. Heard claimed that the reservation of rights created a conflict of interest between her and New York Marine and asked New York Marine to appoint independent counsel. New York Marine refused, but Heard nonetheless retained her own counsel, whose costs were partially reimbursed by another insurer.

New York Marine agreed to reimburse that insurer for a portion of those defense costs and then sought a declaration that it had fulfilled its duty to defend Heard. Heard

counterclaimed, alleging that New York Marine breached its duty to defend by refusing to appoint independent counsel.

DECISION

The court ruled that New York Marine did not breach its duty to defend, rejecting Heard's contention that a conflict of interest arose from New York Marine's reservation of rights such that New York Marine was obligated to pay for independent counsel.

The court explained that, because the defamation suit was litigated in Virginia and because Heard's attorneys were members of the Virginia bar, the conflict-of-interest issue was governed by Virginia (rather than California) law. Under Virginia law, an attorney appointed by an insurer owes a duty only to the insured, not the insurer (whereas under California law, an appointed lawyer owes a duty to both the insured and the insurer). As such, any disputes between an insured and insurer as to coverage do not create a conflict of interest requiring the appointment of independent counsel. The court therefore concluded that New York Marine had no duty to fund Heard's independent counsel.

COMMENTS

The question of whether and under what circumstances a reservation of rights gives rise to a conflict of interest varies by jurisdiction. Many states recognize the distinction between a "potential" conflict of interest, which would not necessarily entitle the insured to independent counsel, as compared to an "actual" conflict, which would require such appointment. For an actual conflict to exist, many states look to whether the facts to be adjudicated in the underlying suit are the same facts upon which coverage depends.

In Two Recent Rulings, Seventh Circuit And California District Court Conclude That Reinsurance Disputes Are Subject To Arbitration

Seventh Circuit Ruling

HOLDING

The Seventh Circuit ruled that the question of whether a previous arbitration award had preclusive effect over a current reinsurance dispute was itself subject to arbitration. *National Casualty Co. v. Continental Ins. Co.*, 2024 U.S. App. LEXIS 29826 (7th Cir. Nov. 22, 2024).

BACKGROUND

National Casualty Co. and Nationwide Mutual Insurance Company (collectively, "National") reinsured Continental Insurance under three agreements, all of which contained arbitration clauses. In 2017, a dispute arose as to whether Continental's billing methodology complied with a "Loss Occurrence" clause in the agreements. In ensuing arbitration, final awards were issued in National's favor. The awards were later confirmed by federal district courts.

In 2023, another billing dispute arose involving the same issue. National argued that the prior arbitral awards resolved the dispute, whereas Continental sought a new arbitration. National then initiated an action in Illinois federal court, seeking declaratory and injunctive relief. In turn, Continental moved to dismiss the action and compel arbitration. The court granted Continental's motion, and the Seventh Circuit affirmed.

DECISION

The Seventh Circuit ruled that the claim preclusion issue (*i.e.*, whether the previous arbitration barred a second arbitration) was itself an issue subject to arbitration. The court stated:

> Our case law establishes that the preclusive effect of an arbitral award is an issue for the arbitrator to decide, not a federal court. In no uncertain terms, we have held that "[a]rbitrators are entitled to decide for themselves those procedural questions that arise on the way to a final disposition, including the preclusive effect (if any) of an earlier award."

The Seventh Circuit rejected National's contention that Section 13 of the Federal Arbitration Act, which states that a district court's order confirming an arbitral award "shall have the same force and effect" as a judgment in an action, casts doubt on the aforementioned rule of law. The court noted that no other court has interpreted that provision to require a federal court to decide the preclusive effect of a prior arbitral award.

COMMENTS

Courts in several other jurisdictions, including Massachusetts and Illinois, have similarly concluded that the preclusive effect of a prior arbitration is a decision for an arbitration panel rather than a court. These decisions and others that assign procedural issues to arbitration panels align with U.S. Supreme Court precedent relating to the expansive reach of arbitration provisions under the Federal Arbitration Act, including to procedural issues that bear on the ultimate disposition of the dispute.

California District Court Ruling

HOLDING

A California district court granted a reinsurer's motion to compel arbitration, rejecting the ceding insurer's assertion that the dispute related to a separate agreement between the parties that did not contain an arbitration clause. *Truck Ins. Exchange v. Certain Underwriters at Lloyd's London*, No. 2:24-cv-08157 (C.D. Cal. Nov. 15, 2024).

BACKGROUND

Truck Insurance entered into a reinsurance agreement with Lloyd's London that reinsured certain liability policies issued by Truck Insurance to Kaiser Cement & Gypsum Company. The reinsurance agreement contained an arbitration clause that applied to "any dispute" between the parties "with reference to the interpretation of this Contract or the rights with respect to any transaction involved."

In the 1980s, a dispute arose as to certain asbestos-related claims that Truck Insurance had paid to Kaiser and for which it sought reinsurance coverage. In 1984, the parties reached an agreement as to how to handle the disputed claims, which was memorialized in a written Memorandum of Understanding ("MOU"). Thereafter, Truck Insurance continued to submit claims to Lloyd's London until 1999.

In 2023, Truck Insurance notified Lloyd's London that it would resume billing and submitted claims for reimbursement in 2024. Lloyd's London demanded that Truck Insurance withdraw its claims or initiate arbitration. Truck Insurance then sued Lloyd's London in California court, seeking a declaration that the MOU did not prevent Truck Insurance from billing the underlying claims to Lloyd's London and that Lloyd's London could not rely on the MOU to reject the reinsurance billings. The amended complaint did not allege breach of contract and did not reference the reinsurance contract.

Invoking the arbitration clause in the reinsurance agreement, Lloyd's London removed the case to federal court and moved to dismiss or stay the action and to compel arbitration.

DECISION

The court granted the motion to stay pending arbitration, finding that the dispute as to reinsurance billings fell squarely within the arbitration clause of the reinsurance agreement. The court rejected Truck Insurance's attempt to portray the MOU as "a wholly separate agreement" not subject to arbitration, explaining that the MOU "by its terms sets forth the parties' understanding of the application of the reinsurance contract to the asbestos-related claims at issue here." In other words, "there is no right to payment under the MOU independent of the reinsurance contract."

While Truck Insurance attempted to cast the dispute as centered only on interpretation of a specific clause in the MOU related to the billing of asbestos bodily injury claims, the court held that to "have a court separately decide the impact of one sentence of the MOU that does not expressly reference the reinsurance contract is not tenable; it relies on an artificial distinction that ignores the fact that the MOU itself interprets the terms of the reinsurance contract."

COMMENTS

The court expressly distinguished this case from decisions involving "wholly separate transactions, with language in the arbitration agreement that did not extend to the subsequent dispute." In contrast, and as the court noted, this case implicated two contracts that were interrelated and interdependent, such that the arbitration clause in one applied to disputes relating to the other.

California Appellate Court Affirms Dismissal Of Coverage Suit Based On Abuse Or Molestation Exclusion

HOLDING

A California appellate court ruled that an abuse or molestation exclusion barred coverage for claims arising out of incidents at a massage spa because the victims were under the "care" and "control" of the spa during the alleged incidents, as required by the exclusion. *Gordon v. Continental Cas. Co.*, 2024 Cal. App. LEXIS 777 (Cal. Ct. App. Dec. 3, 2024).

BACKGROUND

Shen, an owner of a massage spa, and his wife were sued by individuals alleging sexual assault during massage sessions. When Continental refused to defend the suits, Shen and his wife stipulated to liability and a judgment of $6.8 million was entered against them. They assigned their rights against Continental to the plaintiffs in exchange for a covenant not to execute the judgment against them. The plaintiffs then sued Continental for breach of contract, among other claims.

Continental moved for summary judgment based on an exclusion that applied to injuries "arising out of the actual or threatened abuse or molestation by anyone of any person while in the care, custody or control of any insured." The exclusion also applied to injuries arising out of the negligent employment or supervision of any person for whom the insured is legally responsible. A trial court granted the motion, ruling that the exclusion was unambiguous and barred coverage for the underlying claims. The appellate court affirmed.

DECISION

Addressing this matter of first impression under California law, the appellate court ruled that the phrase "care, custody or control" in the exclusion encompassed the factual scenario presented here. The court explained that the victims were under the "care" of Shen because he was responsible for the customers' well being as the massage therapist and were likewise under his "control" because he allegedly used physical force during the incidents.

The court also ruled that the exclusion applied to a claim against Shen's wife alleging negligent training of Shen, finding that such a claim "arises out of" abuse or molestation. The court rejected as unreasonable the assertion that the exclusion did not apply because the word "training" was not included in the subsection related to "supervision."

COMMENTS

Notably, the court rejected Shen's assertion that the phrase "care, custody or control" requires "exclusive or complete" control over individuals. Shen's argument was based on *McMillin Homes Construction, Inc. v. National Fire & Marine Ins. Co.*, 35 Cal. App.5th 1042 (2019), a California appellate court decision involving a policy exclusion for damages to property in an insured's care, custody or control. The insurance dispute in *McMillin* arose out of underlying construction defects. There, the court ruled that a "care, custody or control" exclusion applied only when the insured had exclusive or complete control over the property that had been damaged. The trial and appellate courts in *Gordon* distinguished *McMillin* as involving the care, custody or control over property, rather than human beings.

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