

Risk

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Related Acts and Related Claims Under E&O Policies

By Seth Lamden

Just as Bill Clinton's presidency turned on the meaning of the word "is," it is not uncommon for the resolution of a multi-million dollar disputed insurance claim to turn on the interpretation of a single, commonly-used word. "Related" is an example of one such word. The meaning of the word "related" has generated a significant amount of insurance coverage litigation in the context of interpreting claims-made insurance policies. Although the specific wording of Errors & Omissions and Directors & Officers Liability Policies varies by insurer, many claims-made policies limit or expand the scope of coverage through use of the word "related." Some policies define the term; others do not. Following are three examples of policy provisions in which the term "related" significantly impacts the scope and availability of coverage.

SCOPE OF COVERAGE

By definition, claims-made policies provide coverage only for claims that first are made against the policyholder after the inception of the policy period. It is not uncommon for claims-made policies

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to exclude claims first made prior to the inception of the policy period and claims “related” to claims that first were made prior to the inception of the policy period. Under such policies, insurers may attempt to limit coverage by advancing an overly broad interpretation of the term “related claims” and arguing that claims made after the inception of the policy period somehow should be deemed to have been made prior to the policy period.

POLICY LIMITS

While claims-made policies typically are subject to separate “per claim” and aggregate policy limits, some policies further specify that all “related claims” are subject to a single per claim policy limit. Accordingly, when multiple claims present potential liability in excess of the policy’s per claim limit, insurers may attempt to limit coverage by arguing that the term “related” should be interpreted broadly and that all of the claims should be deemed “related” such that policyholders are entitled to only a single per claim limit for all claims.

DEDUCTIBLES OR SELF-INSURED RETENTIONS

Many policies provide coverage in excess of deductibles or self-insured retentions and some claims-made policies specify that while each claim is subject to a separate deductible or self-insured retention, a series of “related” claims is subject only to a single retention or deductible amount. Insurers facing multiple claims that all were made during the same policy period, therefore, may attempt to limit coverage by advancing a narrow interpretation of the term “related claims” that would subject policyholders to multiple per claim retentions or deductibles. As such, while an insurer seeking to exclude a claim or reduce per-claim limits may advocate for a very broad interpretation of the word “related,” an insurer seeking to increase the number of deductibles or retentions may advocate for a narrow interpretation.

Many courts have held that the word “related” is ambiguous and, therefore, must be interpreted against the insurer and in favor of coverage. See, e.g., *Sigma Financial Corp v. American International Specialty*

Lines Insurance Co., 200 F. Supp. 2d 697, 706 (E.D. Mich. 2001); *American Home Assurance Co. v. Allen*, 814 N.E.2d 662 (Ind. App. Ct. 2005). The cases in which courts have found that the word “related” is unambiguous are very fact-specific and without an in-depth understanding of the underlying facts, may seem contradictory. For example, two courts recently interpreted the same policy provisions regarding the availability of separate per-claim policy limits for “related” claims. Both coverage disputes were similar in that both cases involved multiple claims for legal malpractice brought by the same clients and arising out of the same transactions. One court found the claims to be related and the other found that the claims were not related.

A federal district court in Colorado interpreted the term narrowly and held that two claims against an attorney for professional negligence were not “related,” notwithstanding the fact that the claims involved the same clients and arose out of events surrounding the same transaction. See *Professional Solutions Ins. Co. v. Mohrlang*, No. 07-cv-02481-PAB-KLM, 2009 WL 321706 (D. Colo. Feb. 10, 2009). The policy at issue in *Professional Solutions* provided separate per-claim policy limits for claims that were not “related claims.” The policy defined “related claims” to mean “claims arising out of a single act or omission or arising out of unrelated acts or omissions in the rendering of professional services.” In turn, the policy defined “related acts or omissions” as “all acts or omissions in the rendering of professional services that are temporally, logically or causally connected by any common fact, circumstance, situation, transaction, event, advice or decision.”

The *Professional Solutions* court held that the definition of “related acts or omissions” was unambiguous and “a merely perceivable or conceivable connection between two acts or omissions is insufficient” to establish that claims are “related claims” within the meaning of the policy. *Id.* at * 10. The court held that for multiple acts or omissions to be “temporally connected,” the acts or omissions “must either occur at the same time or one must follow the other sequentially, that is, in a continuous or connected series”; to be “logically connected,” the acts or omissions “must attend or flow from the



The interpretation of even the most commonly-used words may be the difference between coverage and no-coverage.

other in an inevitable or predictable way”; and to be “causally connected,” one act or omission must “lead to the second in a direct and traceable way, and where no independent, significant thing interrupts the causal chain between the two.” *Id.* at *10-11.

Interpreting the same definition of “related claims,” a federal district court in Nebraska held that multiple counts within a single malpractice lawsuit brought by a number of different clients against several attorneys in the same law firm were “related claims” subject to a single “per claim” limit of liability under the terms of a lawyers’ professional liability policy issued to the firm when the clients sought legal services to develop an enterprise of coffee shop franchises. *See Continental*

Casualty Co. v. Orr, No. 8:07CV292, 2008 WL 2704236 (D. Neb. July 3, 2008). The court held that the claims were related because while the attorneys “may have committed separate acts of alleged negligence, with one alleged mistake leading to another, all the allegations center on [attorneys’] acts or omissions related to the [c]lients’ initiation of a coffee shop franchise venture.” *Id.* at *5.

As the *Orr* and *Professional Solutions* decisions illustrate, it is important to review insurance policies carefully and consider the meaning of every word. The interpretation of even the most commonly-used words may be the difference between coverage and no-coverage. **H**

Insurable Interests And Coverage For Time Element Losses

By Doug Gastélum



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First-party insurance policyholders are frequently disappointed when they make Business Interruption, Extra-Expense, or related (collectively “Time Element”) claims. The insurers and policyholders read the policies differently, each side interpreting policies through assumptions that may not be set out in the policy, or the clarity of which may be disputed by the parties.

The parties frequently disagree, for example, on which property must be damaged to trigger the coverage. They may also disagree on which coverage might apply to any loss. In other cases, the parties disagree about whether the cause of damage is covered. This article is limited to the topic of coverage for loss that arises from physical damage to or loss of non-owned property.

BUSINESS INTERRUPTION AND EXTRA EXPENSE COVERAGES MAY APPLY EVEN IF THE PROPERTY DAMAGE IS NOT COVERED

Many policies exclude coverage for damage to certain property, but still provide Time Element coverages that cover loss arising from damage to or destruction of that property. Nevertheless, insurers frequently assert after a loss has occurred that the Time Element coverages of such policies can only be triggered by physical injury or damage to “the *Insured’s real or personal property*.” The cases discussed briefly below describe how Time Element coverages may be triggered in any event.

In *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, 78 Cal.App. 4th 847 (2000), General Mills purchased a manufactured “nut cluster” product from Shade Foods, and later discovered wood chips in the nut clusters. General Mills notified Shade Foods, who in turn notified its contractor, Innovative Product Sales & Marketing, Inc. (“IPS”). Both Shade Foods and IPS tendered claims to their insurers. Although many other issues were considered and decided by the court, as relevant here, the commercial property policy issued to IPS was held liable for the loss of the stock of almonds, even though the almonds were *owned* by Shade Foods.

The court reasoned that (1) the policy covered “stock” on IPS’s premises, (2) that the stock IPS kept on site belonged to others because IPS provided a service

to be performed on that stock, and therefore (3) “[t]he insurance coverage for ‘stock’ would be meaningless if it did not apply to the almonds.” 78 Cal.App. 4th at 874. The court held that IPS had an insurable interest in the almonds, even though it did not own them, because it had “a direct pecuniary interest in the preservation of the property.” *Id.* at 875.

The same definition of an “insurable interest,” and the same coverage analysis, can apply to Time Element coverages when the property of others affects an insured’s business.

Abbey Co. v. Lexington Ins. Co., No. 07-55484 (9th Cir. July 25, 2008), was decided when an engineered waterway, serving a tideland marina, became filled with storm debris, tenants relocated their operations, and the marina operator made a claim for business interruption losses. The insurer argued that the waterway was not “property,” had not been physically “damaged,” and that the marina operator had no insurable interest in it.

The Ninth Circuit disagreed, holding that “[t]he manmade channel... is ‘property.’” Slip Op. at 4. The court further held that, because the insurance policy covered “the interest of the Insured in all real and personal property including... property owned, used, leased or intended for use by the Insured,” and the channel was “clearly ‘intended for use’ by Abbey,” Abbey had an insurable interest in the property. *Id.* Finally, the court held that the storm debris blocking the channel was physical damage.

Burdette Oxygen Co. of Cleveland, Inc. v. Employers Surplus Lines Ins. Co., 419 F.2d 247 (6th Cir. 1969), arose from Burdette’s temporary shut down when one of its machines was damaged. The cost to repair the damage to the machine itself was excluded as a mechanical failure. The policy provided that there must be (1) “damage to property” and (2) that the damage be caused by a “peril insured against” to trigger the Time Element coverage.

The insurer argued that because the property damage was not covered, the Time Element coverage could not be triggered either. The court recognized that there had been (1) property damage and (2) that mechanical breakdown was not an excluded peril, so that the Time

Element coverages were triggered. *Id.* at 249, 250.

The court in *Archer-Daniels-Midland v. Phoenix Assurance Co. of New York*, 936 F.Supp. 534 (S.D. Ill. 1996), considered whether increased costs of transportation and raw materials were covered as extra expenses when the property sustaining physical damage did not belong to the policyholder. The policy at issue included coverage for:

“Extra Expense” sustained by the insured as a result of direct physical damage caused by the perils insured against....

Id. at 537.

ADM’s insurers denied approximately \$44 million in extra expense and other Time Element claims, in part on grounds that the extra expense arose out of damage to property not covered under the policies. ADM argued that the language quoted above required only (1) direct physical damage and (2) that the damage be caused by covered perils. *Id.* Because both of those conditions were met, ADM’s motion was granted as to the extra expenses. *Id.* at 540.

ADDITIONAL TIME ELEMENT COVERAGES MAY APPLY WHEN NON-OWNED PROPERTY IS DAMAGED

Many policies provide “Contingent Time Element” and “Leader Property” coverages, among others, which apply only to business losses resulting from damage to property *other than* property covered by the policy.

One such policy extension includes coverage resulting from damage to:

property that wholly or partially prevents any direct or indirect supplier of goods and/or services to the Insured from rendering their goods and/or services[.]

Many policies also cover loss resulting from damage to a “Leader Property,” typically defined as “property not owned or operated by the Insured, located in the same vicinity as the Insured, which attracts business to the Insured.”

In *Zurich American Ins. Co. v. ABM Industries, Inc.*, 397 F.3d 158 (2d Cir. 2005), the court concluded that damage to the policyholder’s interest in property it used triggered the Time Element coverages. ABM was the janitorial and building maintenance contractor for the World Trade Center when it was destroyed by terrorists on September 11, 2001. In addition to the common areas, ABM had contracts with virtually every tenant in the complex.

The insurer argued that the policy only responded when the insured had a “property interest,” such as ownership or a tenancy, in the damaged property. The court disagreed, holding that the “interest” the policy covers is an “insurable interest.” 397 F.3d at 165.

The insurer further argued that it owed no coverage because ABM did not “use” or “control” the premises. The court rejected this argument as well, holding:

The existence and configuration of the common areas and tenants’ premises were vital to the execution of ABM’s business purpose. These areas and premises were the means by which ABM derived its income and were as essential to that function as ABM’s cleaning tools. 397 F.3d at 165-166.

The court held that ABM *used* the common areas because “the nature of ABM’s business requires movement from its own leased spaces onto another’s property.” *Id.* at 167.

The *ABM Industries* policy had Leader Property coverage that applied to:

“property not owned or operated by the Insured, located in the same vicinity as the Insured, which attracts business to the Insured.” 397 F.3d at 162.

The insurer argued that the complex was not a Leader Property because it was not attracting business to ABM, but “rather [was] itself the site and source of the ABM business here at issue.” *Id.* at 171. The court disagreed and explained that:

Economic forces need not act in the same physical fashion as does a magnet attracting metal. Indeed, it was the interconnectedness of the WTC complex that “attracted” its tenants to ABM’s services by providing an opportunity for ABM to exploit economies of scale. *Id.* at 171.

Accordingly, where “interconnectedness” or some other relationship between policyholder and damaged property attracts customers, Leader Property coverage may obligate an insurer to pay.

CONCLUSION

Most Commercial Property policies contain Time Element coverages. Virtually all of those policies may be triggered by damage to the insured’s property. But some of the coverages may be triggered by damage to property belonging to others as well. **H**

Case Highlights

By Sabahat Chaudhary

CALIFORNIA



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California Supreme Court Holds in Favor of Policyholder in Environmental Contamination Coverage Case

California v. Allstate Ins. Co., No. S149988 (Cal. March 9, 2009)

The California Supreme Court held that a qualified pollution exclusion in a CGL policy did not apply because the covered liability for property damage was related to secondary discharges after the insured's initial pollution. The Court held that where both an uncovered intentional action and a covered accident caused pollution, to the extent the insured could "show 'sudden and accidental' releases proximately caused the damage for which it was held liable, it was contractually entitled to indemnity for that liability."

In this case, the state of California sought coverage for property damage liability imposed against it in a federal lawsuit related to discharges from "Stringfellow Acid Pits," a state-designed and operated hazardous waste facility. All four of the CGL policies at issue on appeal contained coverage exclusions for environmental pollution. Three of the policies "contain[ed] a then standard exclusion, qualified by a 'sudden and accidental' exception as to pollution to land or air, but absolute as to pollution to watercourses and bodies of water."

The trial court applied the pollution exclusions and granted summary judgment to the insurers. The Court of Appeal reversed, holding that "the focus in applying the pollution exclusion was properly on release of pollutants from containment on the Stringfellow site, that triable issues of fact exist as to whether the 1969 overflow of waste was 'sudden and accidental' and whether it discharged pollutants onto land as well as into watercourse, but that the undisputed facts show the 1978 release was *not* 'accidental' because the State had been warned, after the 1969 events, that it needed to cover the ponds to avoid a reoccurrence." The Court of Appeal, relying on *State Farm Mutual Automobile Insurance Co. v. Partridge*, 10 Cal.3d 94 (1973) ("*Partridge*"), held "the policies covered the State's liability for indivisible damage caused partly by covered causes and partly by excluded clauses."

The Supreme Court affirmed the trial court's holding that "because the basis for the State's federal court liability was the escape . . . of pollutants from containment ponds . . . 'the release of the wastes from the site after they had been deposited there by other entities' was the relevant discharge for purposes of determining whether the State's discharge of pollutants was 'sudden and accidental.'" The Supreme Court reasoned that because "[t]he State was *not* held liable for polluting *the evaporation ponds*, but for polluting the land and groundwater *outside the ponds*[,] [t]he relevant discharges for application of the pollution exclusion are those which, due to the State's negligence . . . were released from the evaporation ponds into the surrounding soils and groundwater." The Supreme Court also held that "[b]ecause the wastes were placed *into containment* in the evaporation ponds rather than directly dispersed widely into the environment, the initial deposit of chemical wastes into the Stringfellow ponds was not itself a 'discharge, dispersal, release or escape' within the meaning of the pollution exclusion." The Court further held that as California's liability was based "on its negligence in allowing the *second* set of discharges, not the first," those were the liability-causing events, and not just aspects of property damage.

Regarding the issue of whether California was required to prove the amount of property damage caused by "sudden and accidental discharges," the Supreme Court affirmed the Court of Appeal's decision. The Court found that under the policies, "liability for property damage caused by an accident was covered, while that caused by gradual or nonaccidental release of pollutants was excluded." For damage that was caused by both accidental and gradual release of pollutants, the Supreme Court applied the *Partridge* approach of looking "to whether a covered act or event subjected the insured to liability for the disputed property damage or injury under the law of torts." The Supreme Court held that under California tort law, "[t]he 1969 and 1978 releases would have rendered the State fully liable for the contamination" because under tort law, "a set of injuries for which the damages are indivisible is treated the same as a single injury: the tortfeasor is liable for the entirety of the damages." The Court went on to clarify that its holding disapproved *Golden Eagle Refinery Co. v.*

Associated International Insurance Co., 85 Cal.App.4th (2001), “insofar as it holds an insured must not only show a covered cause contributed substantially to the damages for which the insured was held liable, but also must show *how much* of an indivisible amount of damages resulted from covered causes.” The Supreme Court, held, however, that it was a triable issue of fact as to whether the damages were divisible.

California Court of Appeal Affirms “All Sums” Ruling and Reverses “No-Stacking” Ruling in Pollution Liability

Decision

***California v. Continental Ins. Co.*, No. E041425 (Cal. Ct. App. 4th Dist. Jan. 5, 2009)**

The Fourth District of the California Court of Appeal held that “[w]hen there is a continuous loss spanning multiple policy periods, any insurer that covered any policy period is liable for the entire loss.” As such, the policyholder was entitled to full coverage under all of the triggered policies. The Court also noted that the insurers should not be entitled to a setoff for settlement amounts previously paid by other insurers.

In this action, the state of California sought coverage for liability imposed in a federal lawsuit related to the Stringfellow hazardous waste sites. At issue during this appeal were excess CGL policies issued by six insurers. The trial court had held that that “every policy in effect for any policy period during which the loss was occurring covered the entire loss which was at least \$50 million, and could be as much as \$700 million—subject to the policy limits. The trial court also ruled that the state could not recover more than the total policy limits for any one policy period, ... [and] that the insurers were entitled to a setoff for settlement amounts previously paid by other insurers. Because the state had already recovered approximately \$120 million in settlements, the trial court entered judgment awarding the state \$0 against the insurers.”

The Court of Appeal held that the trial court erred by “ruling that the State could not recover more than the total policy limits in effect for any one policy period.” The remaining issues relating to the insurers’ liability were thus rendered moot.

The Court of Appeal noted that the trial court had

made two rulings, an all-sums ruling in favor of the insured, and an anti-stacking ruling in favor of the insurers. With regard to its all-sums ruling, the trial court had held that “once coverage for ... continuous ... damage ... is triggered under a liability policy, the insurer is required to pay for all sums ... of the insured’s liability—not just liability specifically allocable to damage during any policy period.” With regard to its no-stacking ruling, the trial court held that California “may not ‘stack’ or combine policy period ... [but] is entitled to select a single policy period triggered by continuing damage from occurrence at the Stringfellow site. [It] may recover the full amount [within policy limits] in that period.”

Regarding the all-sums ruling, the Court of Appeal ruled that under California law, “when there is a continuous loss spanning multiple policy periods, *any* insurer that covered *any* policy period is liable for the *entire* loss,” up to policy limits. Thus, “[t]he insurer’s remedy is to seek contribution from any other insurers that are also on the risk.”

Regarding the no-stacking ruling, it ruled that, under California law, “[u]nder the all-sums approach, each of these insurers is liable up to the amount of the entire loss as a result of an occurrence, subject only to its own policy limits. Thus, even though there is only one occurrence, the insured should be entitled to recover against each insurer up to the limits of the insurer’s policy.”

The Court of Appeal held that “[w]hen multiple policies apply during a single policy period, the insured is entitled to stack limits,” finding that in “our view, standard policy language *does* provide for stacking, and therefore that is *exactly* what the insured has bargained and paid for.” The Court concluded that “[t]he trial court’s non-stacking ruling was therefore erroneous.”

Lastly, regarding the trial court’s setoff holding, the Court of Appeal noted that policyholders are under no duty to liability insurance companies to mitigate their losses. The Court went on to state that because the “California Supreme Court has refused to recognize a duty to mitigate the loss under a third-party liability policy,” California “had no duty to the insurers to mitigate the loss, by undertaking remediation measures or otherwise.” The Court reversed the trial court decision and remanded the case.

California Superior Court, San Francisco County, Holds that Defense Costs Owed in Addition to Umbrella Policy Limits.

***Yarway Corp. v. Admiral Ins. Co.*, No. CGC-04-435399 (Cal. Super. Ct. March 2, 2009)**

The Superior Court of California, San Francisco County, held, following a bench trial on asbestos claims coverage, that OneBeacon America Insurance Company (“OneBeacon”) was obligated to pay defense costs in addition to its limits of liability on two umbrella policies issued by OneBeacon’s predecessor.

The insured, Yarway Corp., initiated a declaratory judgment action seeking defense costs and indemnity coverage from various insurers for asbestos-related bodily injury lawsuits. The insured and one insurer, OneBeacon, bifurcated issues for a bench trial with respect to its two umbrella policies.

The Court began with its analysis by noting that the OneBeacon umbrella policies “confer[ed] on OneBeacon a duty to defend, with defense costs to be borne in addition to the applicable limits of liability, ‘with respect to an occurrence which is not covered by any policy of underlying insurance...and to which there is no other insurance in any way applicable.’”

At issue was interpretation of the phrase “no other insurance in any way applicable.” OneBeacon argued that the language “in any way” qualified the term “applicable,” such that it “encompasses all insurance policies that could at any time cover the kind of occurrence or injury at issue, regardless of the level of that insurance or whether coverage has been activated.” Under its interpretation, OneBeacon had no supplemental duty to defend as long as any other insurance is left unexhausted, including “higher levels of insurance, policies that settled for less than the full policy limits, or policies that have settled and are making payments to Yarway over time.” The Court noted that OneBeacon’s argument assumed that “insurance that is, or might become, ‘applicable’ at some point in time is ‘applicable’ at all points in time.”

Yarway countered that the term “applicable” referred only to insurance “that would actually cover the occurrence at issue” thus excluding higher levels of insurance that could not be applied because it had not yet been triggered. The insured argued that the phrase “‘in any

way applicable’ must be assessed at different specific points in time, based on the nature of Yarway’s covered liabilities as they evolve over time.” The Court reasoned that the insured’s argument was that “the phrase ‘in any way applicable’ does not mean ‘in any way *potentially* applicable,’ but instead the phrase intends to capture any policy that” is providing coverage at the time the OneBeacon policy is triggered.

The Court held that the policy language was ambiguous. First, it found both policy constructions to be reasonable. The Court reasoned that “[l]ooking at the plain language of this provision, although the qualifying phrase ‘in any way’ certainly confers a broad meaning on the term ‘applicable,’ that meaning can only extend as far as the boundaries of the definition of the word ‘applicable;’ that is, the qualifying phrase cannot expand the meaning of the modified term.” Thus if OneBeacon had wanted to “confer such a broad meaning with such potentially surprising consequences as the interpretation that it now propounds, it needed to have used more precise language.”

Second, it found the policy language ambiguous in the context of the entire policy and under a common sense reading. Regarding the common sense reading, the Court also reasoned that it was not common sense for OneBeacon to have issued two umbrella policies for different years and yet to “not have a supplemental duty to defend under either policy as long as the other policy was not exhausted.” The Court found that this was “unexpected” as a consequence of the policy language and gave OneBeacon a virtual “escape clause.” Such a reading was against public policy, which frowns upon clauses “whereby coverage purports to evaporate in the presence of other insurance.”

NEW YORK

New York Insurance Department Requires Insurers to Defend in D&O Policies

Opinion of the Office of General Counsel of the New York State Insurance Department, Re: Duty to Defend – Directors’ and Officers’ Policies, OGC Op. No. 08-10-07 (October 16, 2008).

The Office of General Counsel (OGC) of the New York State Insurance Department (NYSID) issued an

opinion stating that “a D&O liability policy may not include a provision that places the duty to defend upon the insured, rather than the insurer.” The OGC opined that “[a] policy that places the duty to defend upon an insured would run afoul of Regulation 107 because it would limit the availability of coverage for legal defense costs.” Regulation 107 reads in relevant part that “the insurer generally has a duty to defend any liability suit coverage under the policy in which damages are sought. This duty to defend typically has been separate and apart from the obligation to pay damages under the policy, and accordingly, the insurer must provide a proper defense regardless of cost.” 11 NYCRR § 71.0(d)(1). The OGC reasoned that “[b]y placing the duty upon the insured, the policy would condition defense cost coverage upon the insured taking charge of the defense,” and thereby run afoul of New York insurance law.

The OGC also opined that Regulation 107 does not authorize “allocation of defense costs between covered and noncovered matters,” because “where the insurer has a duty to defend, in any action in which at least one claim may possibly fall within the coverage, the insurer has the duty to defend all claims in the action.”

The OGC went on to clarify that the NYSID’s opinion was not based on the New York Legislature’s “failure to pass legislation that would have addressed the defense obligation under directors’ and officers’ liability policies by exempting them from the requirement that the insurer have the duty to defend the insureds.” Rather, the OGC stated that it was based on the reasons stated in its opinion, and that “[a]lthough the Department supported passage of such an amendment, the Department may not now enforce the Insurance Law as if the Legislature had passed it.”

TEXAS

Texas Supreme Court Extends Late-Notice Prejudice Rule to Claims-Made Policies

***Prodigy Commc’ns Corp. v. Agric. Excess & Surplus Ins. Co.*, No. 06-0598, 2009 WL 795530 (Tex. March 27, 2009).**

The Texas Supreme Court extended its notice-prejudice rule from *PAJ, Inc. v. Hanover Insurance Co.*,

243 S.W.3d 630 (Tex. 2008) (“PAJ”), to claims-made policies by holding that under such a policy, an insurer may not deny coverage based on late notice unless it can show it was prejudiced by the delay or unless the notice was given beyond a time period explicitly required by the policy.

The underlying suit was a securities class action filed against a predecessor to Prodigy Communications Corp. (“Prodigy”). The predecessor was insured under a claims-made “Directors’ and Officers’ Liability Insurance Policy Including Company Reimbursement” issued by Agricultural Excess & Surplus Insurance Company (AESIC). The policy contained a notice of claim provision that required the insured “as a condition precedent to their rights under this Policy, give the Insurer notice, in writing, as soon as practicable of any Claim first

The trial court granted summary judgment to the insurer and held that “Prodigy failed to comply with the condition precedent of timely notice and that this failure ‘avoids coverage, with or without prejudice to AESIC.’”

made against the [Insureds] during the Policy Period, or Discovery Period (if applicable), but in no event later than ninety (90) days after the expiration of the Policy Period, or Discovery Period.” Prodigy was served with the underlying complaint on June 20, 2002 and first notified AESIC of the lawsuit on June 6, 2003. That letter assumed AESIC already knew of the lawsuit and requested AESIC consent to a settlement agreement. On June 18, 2003, AESIC denied coverage on the basis that the June 6 letter did not comply with the notice requirements. In response, Prodigy provided written notice on June 26, 2003.

The trial court granted summary judgment to the insurer and held that “Prodigy failed to comply with the condition precedent of timely notice and that this failure ‘avoids coverage, with or without prejudice to AESIC.’” The appellate court affirmed, holding that

“(1) Prodigy was required to give notice ‘as soon as practicable,’ even though the policy allowed notice within ninety days after the expiration of the discovery period; (2) notice given almost one year after the filing of the lawsuit against the insured was not ‘as soon as practicable’ as a matter of law; (3) AESIC was not required to prove that it was prejudiced by Prodigy’s late notice...; and (4) Insurance Code provisions did not prevent AESIC from enforcing the policy’s notice provision.” The Texas Supreme Court granted Prodigy’s petition for review.

Regarding the late notice issue, the Supreme Court cited its recent holding in *PAJ* “that an ‘insured’s failure to timely notify its insurer of a claim or suit does not defeat coverage if the insurer was not prejudiced by the delay.” The insured argued that even assuming breach of the “requirement that notice of a claim must be given ‘as soon as practicable,’” under *PAJ*, the breach was immaterial.

First, the Supreme Court rejected the insurer’s argument that *PAJ* did not apply because the policy required the insured to “give ‘notice, in writing, as soon as practicable’” as a “condition precedent” to coverage. The Supreme Court held that *PAJ* did not rely on such a distinction but rather on “the extent to which the nonbreaching party will be deprived of the benefit it could have reasonably anticipated from full performance.”

Second, the Supreme Court also rejected the insurer’s argument that, unlike the occurrence-based policy at issue in *PAJ*, for a claims-made policy, “timely notice is always inherent to, and an essential part of, the bargained-for exchange in a claims-made policy.” The Supreme Court reasoned that “the main difference between these two types of policies is that a ‘claims-made’ policy provides unlimited retroactive coverage and no prospective coverage, while an ‘occurrence’ policy provides unlimited prospective coverage and no retroactive coverage.” Thus, the Court explained, for the insurer, “the primary advantage of the claims-made policy “is the limitation of liability to claims asserted during the policy period,” which allows it to “calculate risks and premiums with greater precision.”

Regarding notice requirements in the two types of policies, the Court noted that both “tend to have a requirement that notice of a claim be given to the insurer promptly, ‘or as soon as practicable,” though “some claims-made policies . . . have an additional requirement that the claim be reported to the insurer within the policy period or within a specific number of days thereafter.” The two types of notice requirements serve different purposes. The “as soon as practicable” requirement allows the insurer to investigate and participate in third-party negotiations. In contrast, the “requirement that the claim be made during the policy period ‘is directed to the temporal boundaries of the policy’s basic coverage terms”; rather than being “simply part of the insured’s duty to cooperate, [it] defines the limits of the insurer’s obligation,” such that “if there is no timely notice, there is no coverage.” The Court noted the same reasoning applied to those policies that required notice “during the policy period or within a specific number of days thereafter.” The Court concluded that “most courts have found that an insurer need not demonstrate prejudice to deny coverage when” the notice is not made within the specified time frame.

The Supreme Court held that in “[i]n a claims-made policy, when an insured notifies its insurer of a claim within the policy term or other reporting period that the policy specifies, the insured’s failure to provide notice ‘as soon as practicable,” will not defeat coverage in the absence of prejudice to the insurer.”

The Court held that Prodigy had given notice within the ninety-day period, and even if it had not given notice “as soon as practicable,” the insurer “was not denied the benefit of the claims-made nature of its policy as it could not ‘close its books’ on the policy until ninety days after the discovery period expired.” Because the insured’s obligation to provide notice “‘as soon as practicable’ was not a material part of the bargained-for exchange under this claims-made policy,” and there was no prejudice from the delay of notice, and the Court held that the insurer cannot deny coverage because of a “failure to give notice ‘as soon as practicable.’”

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HOWREY INSURANCE IN THE NEWS

ACCOLADES

In March 2009, **Jill B. Berkeley** (Chicago); **Robert Shulman** (Washington DC) and **David Steuber** (Los Angeles) were selected as “Best Lawyers in America 2009” in insurance recovery. According to its website, Best Lawyers is “the oldest and most respected peer-review publication in the legal profession. For a quarter century, Best Lawyers has helped lawyers and clients find legal counsel in unfamiliar jurisdictions or unfamiliar specialties.”

ARTICLES

David Steuber (Los Angeles) was quoted in the *Business Insurance* article “Future of AIG not clear, but it probably will ask for more government help” on Monday, March 9, 2009.

David Steuber (Los Angeles) was quoted in the *www.thestreet.com* article “AIG Bailout Details Don’t Tell the Full Story” on Monday, March 16, 2009.

On Wednesday, March 18, 2009 **David Steuber** (Los Angeles) was a guest on FOX Business Live to discuss the future of AIG.

On Monday, March 16, 2009 **Jill B. Berkeley** (Chicago) and **Curtis Porterfield** (Los Angeles) were quoted in the *Business Insurance* articles, “Cleaning house? Don’t throw out old documents” and “Ways to track down an old insurance policy”

On Wednesday, March 18, 2009 **Stephen Masterson** (Los Angeles) was quoted in the *www.law360.com* article, “Clarifying ‘Sudden And Accidental’ Pollution Coverage.”

SPEAKING ENGAGEMENTS

Amy Fink (Los Angeles) will be presenting “Potential Insurance Coverage Issues Arising from Nanotechnology: Big Risks Could Come in Small Packages” at The 3rd International Congress of NanoBiotechnology & Nanomedicine NanoBio 2009, June 22-24, 2009, San Francisco, CA

On Wednesday, April 22, 2009 **Ty Childress** (Los Angeles) presented on the topic “Who Owes Whom What? Indemnity and Additional Insured Issues” at the Risk and Insurance Management Society, Inc. (RIMS) 2009 Annual Conference, Orlando, Florida.

On Tuesday, April 21, 2009 **Mary Craig Calkins** (Los Angeles) was a panelist for the presentation “Top Ten Litigation Traps for Risk Professionals,” at the Risk and Insurance Management Society, Inc. (RIMS) 2009 Annual Conference, Orlando, Florida.

On Tuesday, March 21, 2009 **Mary Craig Calkins** (Los Angeles) presented “How The Changing Focus of Securities Litigation Against Financial Institutions Impacts D&O Insurance: Defensive and Proactive Strategies for Minimizing Losses,” at the American Conference Institute Advanced Forum on Financial Institutions Insurance, New York, New York.

On Saturday, March 7, 2009 **Helen Michael** (Washington DC) gave the presentation, “Not Your Father’s Allocations: Practical Solutions for Modern long-Tail Insurance Claims” at the 2009 Insurance Coverage Litigation CLE Seminar in Atlanta, Georgia.

On Friday, March 6, 2009 **Mary Craig Calkins** (Los Angeles) presented “Gotcha! Top Ten Insurance Settlement Traps,” at the ABA Section of Litigation Insurance Coverage Annual CLE Meeting, Tucson, Arizona.

On Tuesday, May 5, 2009 **Mary Craig Calkins** (Los Angeles) presented on “Key Directors & Officers and Fiduciary Liability Coverage Issues,” at the Practising Law Institute Insurance Coverage 2009: Claims Trends in Litigation, New York, New York.



IN MEMORY OF

Patrick J. McDonough, 1943-2009

The partners and staff of Howrey LLP regret to announce the passing of their dear friend and partner, Patrick J. McDonough on March 24, 2009. Pat McDonough was an active member of local bar associations and held leadership positions with many groups, including the Institute for Corporate Counsel, which he helped found, and the insurance and corporate law branches of the California State Bar Association. Pat was an outstanding man, father, grandfather, husband, friend, and lawyer. He will be greatly missed.

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Clients hire Howrey for the extraordinary depth and breadth of our advocacy capabilities within three principle areas of law—Antitrust, Intellectual Property and Complex Commercial Litigation and Arbitration. We are the only firm among the Am Law 100 and the Global 50 with such concentration. With each practice area having more than 200 experienced attorneys, our clients benefit from the substantial expertise and comprehensive resources this focus provides.

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