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Mergers and Acquisitions: Insurance Can Make, Break or Protect the Deal

by Amy J. Fink



As companies continue to grow by merger and acquisition, in order to protect both the buyer and seller in such transactions, it is critical that companies in the deal cycle consider insurance coverage issues as part of their due diligence review. In addition to understanding existing and potential liabilities, buyers need to have a clear understanding of whether they can and will be acquiring any insurance coverage for such liabilities from the seller. Moreover, to the extent that a buyer may be acquiring liabilities, but not insurance coverage, a fundamental concern is whether it can obtain insurance coverage for such liabilities by purchasing the appropriate insurance.

Similarly, sellers need to assess the potential impact of transferring policies that may be applicable to liabilities that remain with the seller prior to determining whether such assets should be part of the deal. Further, both parties should consider obtaining coverage for liabilities relating to the deal itself. A summary of some of the key insurance issues that should be addressed in mergers and acquisitions is set forth herein.

Analyzing Existing and Potential Liabilities

Knowing what risks are insured versus those that are uninsured is fundamental to identifying any deal-breaking exposures to financial loss. Existing uninsured liabilities that are to be assumed by the buyer as well as historical and future insured and self-insured liabilities of the seller must be identified and quantified. In assessing risk, matters in litigation, legal compliance issues, current and historical operations, and whether there are any unusual or hazardous or uninsurable operations, products, physical assets or geographic locations must be thoroughly explored and evaluated.

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RIMS 2006 Annual Conference

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Hurricane Damage to the Oil & Gas Industry: Insurance Companies Should Share the Cost

by Lester Brown



Recent hurricanes in the Gulf of Mexico have had a negative impact on the nation's domestic energy infrastructure.

According to the Federal Minerals and Management Service, as of October 25, 2005, 238 oil platforms and 24 oil rigs in the Gulf of Mexico remained abandoned. Gulf oil production was down over a million barrels a day or over two-thirds of the usual daily production. Gas production was off more than five thousand million cubic feet a day, down fifty percent from the average daily

paid higher and higher premiums for such coverage over the years. CEOs, CFOs, Boards of Directors and shareholders of these companies are now asking the questions: Was payment of those premiums worth it? Do we have insurance to cover at least some of those losses?

Many oil and gas companies purchased insurance to minimize the impact of hurricane-related losses. Indeed, faced with the difficult task of obtaining catastrophic property damage loss coverage, a significant segment of the industry was forced many years ago to form its own mutual, OIL

industry in turn purchased extensive reinsurance to protect themselves from oil and gas industry losses. As a result, the risks have been spread not only throughout the marketplace, but throughout the world.

In an effort to protect their own financial interests, insurance carriers likely will resist certain hurricane-related claims made by energy companies. Arguments have already surfaced regarding what is covered. Some insurers may argue it was the flooding, not the covered broader hurricane that caused the losses. Some may even argue that actions taken to mitigate or prevent

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production. Cumulative gas shut-ins exceed 348 BCF. The value of lost production of oil alone totals more than \$3.5 billion. In addition, the Congressional Budget Office estimates that capital losses in the energy-producing industries will range from \$18 billion to \$31 billion, based on a rough assessment of the value of structures damaged.

Many, if not most, companies have taken prudent steps to try to avoid losses from such natural disasters. One of these steps is the purchase of insurance. The oil and gas industry, no stranger to the devastating impacts of natural disasters, has

Limited ("OIL"). Over the years, OIL has been a leader in providing broad based property damage insurance to its members. OIL does not provide business interruption ("BI") coverage. Nevertheless, the OIL policies have served as the core of these programs with the commercial insurance policies often following or even providing broader coverage, including BI coverage, above and below the coverage provided by OIL. These comprehensive commercial insurance policies are often referred to as "wrap around" policies. The commercial insurance companies that sold these policies to the energy

more extensive damage are not covered because they actually improved the facilities involved.

The basic OIL policy provides very broad coverage. This wording is particularly beneficial to policyholders where more than one cause, i.e., one covered and one not covered, may have contributed to the loss. For example, the OIL policy makes clear that a covered occurrence involves losses "which are attributable directly or indirectly to one accident, event or cause . . ." Thus, where more than one cause is involved, e.g., water and wind, under this broad wording the loss

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COLI: Businesses Face New Risks from Court Decisions and Legislation

by Stephen D. Libowsky



For many decades, corporations and other entities have used cash value life insurance to fund corporate obligations expected to occur at some point in the future. These future obligations included the buying of the stock or

many years. Companies can use the death benefits to recoup benefits paid or to pay future benefits and can use the cash values in the policies as collateral or as a loan funding source.

Corporate-owned life insurance (COLI) is a funding choice along

Over the last several years, restrictions or challenges to COLI policies have occurred, all of which attempt to restrict or strike a different balance on whether COLI can or should be used as a funding option for companies. For example, even though Congress had previously imposed certain restrictions on how

Some corporate purchasers have claimed that the insurance carriers, insurance brokers and insurance administrators misled or failed to disclose the risks in purchasing COLI policies.

other ownership interests upon the death or retirement of a shareholder or partner or to pay post retirement benefits to executives or other employees. Life insurance has been a uniquely appropriate funding method for these obligations since the cost of the obligation is based in whole or in part on how long a person or a group of people will live.

Life insurance also has traditionally enjoyed certain tax-favored treatment under the tax code making it, at times, the best choice for funding future obligations. The death benefits paid from a life insurance policy are generally free from tax. The cash build-up—the growth of funds within the policy due to interest payments or dividends from the insurance carrier on funds on deposit in excess of the actual cost of insurance—generally are tax deferred while the cash remains in the policy. Purchasing cash value life insurance policies on the lives of employees has been prevalent for

with stocks, bonds and every other type of financial asset. COLI, like virtually every other type of financial instrument, can come in simple, complex or even exotic forms. The principle is the same—how to fund, directly or indirectly, some corporate obligation—but the manner by which the COLI policies are purchased and used can vary widely.



much loan interest paid could be deducted as a business interest expense, in 1996, Congress passed legislation designed to prohibit interest deductions for most broad based COLI programs. Some states, by court decision or legislation, made decisions as to when and how a company has an “insurable interest” in its employees.

These restrictions and challenges have spawned litigation on several fronts. Some corporate purchasers, after Congress changed the ability to deduct interest payment made on policy loans, have claimed that the insurance carriers, insurance brokers and insurance administrators misled or failed to disclose the risks in their purchasing COLI policies. (*Wal-Mart Stores, Inc. v. AIG Life Insurance Co.*, filed September 2002 (New Castle County, Delaware); *Eastman Kodak Co. v. Hartford Life Insurance Co.*, filed April 2003 (Morris County, New Jersey); *American Greetings Corp.*

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INSURANCE COVERAGE CASE HIGHLIGHTS



These summaries are not intended to be an exhaustive analysis of legal developments in the insurance field. Rather, they are an overview of recent “highlights” of developments in selected states. Should the need arise, Howrey is able to assist its clients in a more detailed analysis of recent legal developments pertaining to insurance coverage in any state. The following highlights have been provided by James G. Bernald, an Associate in our Los Angeles office.

CALIFORNIA

Insured Entitled to be Equitably Excused from Strict Reporting Requirement

Root v. American Equity Specialty Ins. Co., 130 Cal. App. 4th 926 (June 28, 2005)

The California Court of Appeal recently held that an insured attorney could be excused from the strict reporting requirements of a claims made and reported professional malpractice policy.

In *Root*, the insured attorney had a legal malpractice insurance policy, with a policy period of February 28, 1998 to February 28, 1999. On February 25, 1999, one of *Root*'s former clients filed a malpractice suit against *Root*, however, the former client did not serve her complaint until after February 28, 1999. On February 25, 1999, *Root* received a phone call from someone at a legal journal, who asked for *Root*'s reaction to the lawsuit. *Root* believed the phone call to be a possible prank, and did not immediately report the claim. On March 2, 1999, *Root* read an article in the legal journal describing the lawsuit against him, and then reported the claim to his malpractice carrier. The carrier denied *Root*'s claim because *Root* had not reported the claim during the policy period.

Root filed suit against the insurer American Equity, but the trial court granted summary judgment to the insurer based on the lack of any report during the policy period.

On appeal, the Court of Appeal reversed. Acknowledging that typically the reporting requirement was a condition precedent to coverage, the Court noted that California's common law traditionally allowed for the equitable excusal of the non-occurrence of a condition precedent (e.g., the report during the policy period) when such non-occurrence results in a disproportionate forfeiture. Ultimately, the Court held that *Root* was equitably excused from having to timely report a malpractice claim made extremely late in the reporting period. In effect, the Court adopted a rule granting insureds a short “grace period” after the end of the policy period to report the claims. the Court emphasized, however, that it was not adopting a “notice-prejudice” rule with respect to claims made and reported policies, which would require that the insurer prove that it was prejudiced by the insured's late reporting to uphold a denial of benefits.

Negligence Claims Against Broker Not Barred When Court Rules for Insured in Coverage Action

Third Eye Blind, Inc. v. Near North Entertainment Ins. Services, 127 Cal. App. 4th 1311 (March 29, 2005)

The Court of Appeal held that a negligence claim against a broker should not be dismissed automatically simply when the insured proves that the insurance claim was in fact covered under the applicable policy.

A former member of the band Third Eye Blind filed a lawsuit against the band. Third Eye Blind tendered the lawsuit to its CGL insurer, North American Specialty (NAS), for a defense and indemnity. NAS denied the claims on the basis that the band had limited coverage pursuant to a Field of Entertainment Limitation Endorsement (FELE) contained in its CGL policy.

Third Eye Blind filed suit against NAS, as well as its insurance broker, Near North. In its negligence cause of action against the broker, Third Eye Blind alleged that, despite its claimed expertise in the field of entertainment industry

insurance, Near North failed to advise the band that it did not have full coverage, in light of the FELE in its policy.

The court ultimately ruled that, indeed, NAS had breached its duty to defend Third Eye Blind. The trial court then dismissed Third Eye Blind's claims against the broker, on the basis that the claim against the broker was predicated on a claim that the NAS CGL policy was insufficient.

The California Court of Appeal reversed, holding that a finding of wrongdoing by the insurer does not necessarily absolve the broker of its own responsibility for damages proximately caused by its negligence.

TEXAS

Court will not Consider Insured's Answer when Determining Whether Insurer has Duty to Defend

State Farm Lloyds v. Chander, 2005 WL 2467071 (E.D. Tex Oct. 6, 2005)

In *Chander*, the insured landlords, who were sued by tenants for failure to properly maintain the property, tendered the tenants' claim to their insurer, State Farm Lloyds. The insurer, however,

relied upon a mold exclusion present in the policy to deny coverage. In the subsequent coverage action, the insureds argued that their Answer to the tenants' complaint, which denied that there was any life-threatening exposure to mold at the apartment, raised a genuine issue of material fact sufficient to preclude summary judgment in the insurer's favor.

The district court, relying on what it called the "Eight Corners Rule," held that a court may examine only two sources to determine the insurer's duty to defend an underlying action (e.g., the action brought by the tenants): (1) the allegations in the complaint; and (2) the provisions of the insurance policy. Thus, the court would not consider the allegations present in the insured's Answer to the underlying action, or any other extraneous evidence or allegations. The Court found that the tenants' allegations fell under the mold exclusion, and granted State Farm Lloyds's motion for summary judgment on the issue of the duty to defend.

ILLINOIS

Right to Privacy Included Right to Secrecy and Right to Seclusion in Personal and Advertising Injury Coverage

Rejecting an earlier Seventh Circuit opinion, *American States Ins. Co. v. Capital Assoc. of Jackson County, Inc.*, 392 F.3d 939 (7th Cir. 2004), the Illinois Court of Appeal held that unsolicited fax advertising constituted personal and advertising injury, and thus the insured fax advertiser was entitled to a defense from its liability insurer, Valley Forge.

Typically, personal and advertising injury provisions provide coverage against claims for invasion of privacy, which represents two distinct interests: the right to secrecy, and the right to seclusion. Relying on language in the policy that requires "publication" for there to be personal or advertising injury, however, the *American States* court held the right to privacy referenced in personal and advertising injury coverage only dealt with a right to secrecy, rather than a right to seclusion.

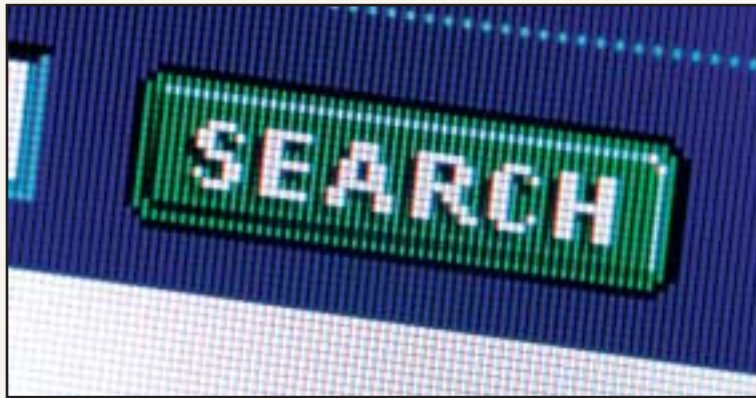
The Illinois Court of Appeal rejected the reasoning in *American States*, citing to Illinois insurance law, which requires that, in ascertaining whether there is a duty to defend, the underlying complaint and insurance policy are to be liberally construed in favor of the insured, with all doubts and ambiguities to be construed in favor of the insured. The court therefore found that the plain and ordinary meaning of privacy included the right to be left alone, i.e., the right to seclusion.



Valley Forge Ins. Co. v. Swiderski Electronics, Inc., 834 N.E.2d 562 (Ill. Ct. App. 2005)

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For example, the buyer needs to carefully calculate the liabilities arising out of the recall of products of a subsidiary of the seller. Specific areas to be addressed also include whether there are any long tail product claims, requisite disclosures in regard to environmental remediation, OSH Act and EEOC violations, or directors and officers or employment practices suits.



potential risk management programs and employee benefit programs of the

is important that the selling company's pre-acquisition insurance policies are compiled prior to the completion of the transaction because the seller will not have much incentive to do so after the transaction has been completed.

Among other things, whether policies are "claims-made" policies that have already expired

Historical loss data and exposure data must be compiled and analyzed. In general, the primary sources of information about the seller's risks and financial obligations are loss statistics or copies of actual loss runs. In addition, loss-trending data (such as data establishing the length of time that it takes for workers' compensation and liability claims to develop to their final, ultimate value), as well as the amount reserved on the general ledger should be obtained and analyzed. Furthermore, the terms of the deal itself, such as whether there are

seller should be thoroughly analyzed. The buyer should request complete copies of all policies; including property/casualty and health insurance policies as well as the policy premium and applicable rating basis. In addition, the buyer should request and review schedules of insurance depicting the limits of insurance, any deductibles or self-insured retentions, the identity of the insurers, the policy periods, and the premiums paid. Key among the purpose for the insurance program review is to identify potential coverage and limit deficiencies with current insurance programs. Further, taking

or will expire before closing, the absence of certain types of insurance, the adequacy of coverage limits, and the existence of unique exposures that may require special types of insurance for which there may only be limited availability at high premiums, should be considered. Further, the solvency of the insurers, both present and historic, should be examined.

Moreover, a fundamental question that needs to be considered at the onset of any deal is whether the sold business will be absorbed into the insurance program of the buyer or whether it will have to operate on a

It is important that the selling company's pre-acquisition insurance policies are compiled prior to the completion of the transaction because the seller will not have much incentive to do so after the transaction has been completed.

indemnification provisions pertaining to self-insured or uninsured liabilities, must also be considered.

Analyzing Applicable Coverage

The insurance coverage programs,

measures to reconstruct the selling company's historic insurance coverage programs can provide insight into whether coverage may exist for claims made against it for injury or damage caused by, or attributable to, historic operations. It

stand-alone basis. Thus, the risk management implications of the sales agreement and risk assumptions should be analyzed.

The terms of the deal itself should be clear with respect to whether the

acquiring company has rights under the selling company's pre-acquisition insurance policies. In corporate mergers, the predecessor's assets (including its insurance coverage) and liabilities are transferred to the successor as a matter of law. See California Corporations Code § 1107(a); *Quemetco Inc. v. Pacific Auto. Ins. Co.*, 24 Cal. App. 4th 494, 503 (1994). The predecessor's insurance coverage also passes to the successor where there has been a *de facto* merger. See *Westoil Terminals Co. v. Harbor Ins. Co.*, 73 Cal. App. 4th 634, 640 (1999).

The term of the deal itself should be clear with respect to whether the acquiring company has rights under the selling company's pre-acquisition insurance policies.

However, in the context of other transactions, such as asset purchases, and in order to avoid ambiguity, the buyer should insist on language that expressly states that rights to insurance coverage under all of the selling company's pre-acquisition insurance policies are included among the assets being purchased, and a schedule of such policies should be included in the purchase agreement. In considering issues of successor liability with respect to insurance policies, in general, courts will often first consider the manner in which the liability is being imposed upon the purchaser i.e., whether the purchaser assumed the liability as a matter of contract, or whether the liability is being imposed upon the purchaser as a matter of law. The second line of inquiry is whether

there exists a basis, either as a matter of contractual agreement or as a matter of law founded in public policy, to grant the successor a legally cognizable interest in insurance policies that were issued to and paid for by a predecessor company. See *Albert Bates, Jr. IV, D. Matthew Jameson III, Bren J. Pomponio, Asset Purchases, Successor Liability, and Insurance Coverage: Does the Tail Always Follow the Dog*, 100 W.Va L. Rev. 631 (1998). Thus, even if the asset purchase agreement does not expressly acknowledge the intent to transfer rights to insurance coverage, absent express language to the contrary, such rights may transfer by operation of law.

Further, if policies are to be assigned, the validity of such transfers should be analyzed, including the existence and enforceability of so-called "anti-assignment" provisions. Many states recognize the validity of contractual provisions against assignment of contracts, including insurance policies. See, e.g., *Employers Mut. Liab. Ins. Co. v. Mich. Mut. Auto. Ins. Co.*, 101 Mich.App. 697, 702 (1980); *Henkel Corp. v Hartford Accid. & Indem. Co.*, 29 Cal.4th 934 (2003). However,

Whether such provisions will be enforced if a seller assigns such policies to other entities will depend upon the nature of the liability for which coverage is being sought as well as the nature of the succession. See, e.g., *Northern Ins. Co. of New York v. Allied Mutual Insurance Co.*, 955 F.2d 1353, 1357-1358 (9th Cir. 1992) (Court held that because an insurer's risk does not increase where the loss or liability arose prior to the transfer, in corporate transactions such as asset purchases, asset and liability purchases or stock



sales, in general, where a liability is pre-existing and known (i.e., a claim has been made) to the predecessor corporation, an assignment of an insurance policy to a successor corporation will be called a "post-loss assignment" and upheld.) Cf., *Red Arrow Production v. Employers Ins. of Wausau*, 233 Wis.2d 114, 607 N.W.2d 294 (Wis. Ct. App.

2000) (Setting forth the minority view, that tort principles of successor liability should not be applied to extend insurance coverage to non-parties to the insurance policy.) Thus, the policies themselves as well as the applicable law need to be addressed prior to assuming that policies will be transferred in conjunction with a merger or acquisition.

Deal-Related Insurance

Insurance can also be used as a safety net and to help close a transaction. For instance, buyers can obtain Representations and Warranties (“R&W”) insurance coverage for loss resulting from a breach of a representation and warranty by the seller, thereby augmenting or replacing the seller’s duty to indemnify the buyer for a breach of a

representation or warranty. Similarly, sellers can obtain R&W insurance to protect them from loss incurred in conjunction with suits brought by the buyer for R&W breaches.

Uninsured litigation liabilities that may be impacting a deal can be specifically insured to either quantify or eliminate the liabilities. In addition, potential tax exposures can be insured either within a R&W policy, or by a specific tax insurance policy. Loss portfolio transfer insurance allows a buyer or seller to bundle a company’s Workers Compensation, Directors & Officers, and General Liability claims incurred before a merger and transfer these claims to an insurer at a fixed cost. Thus, insurance may provide a means to provide a “clean slate” approach to companies carrying large

deductibles or self-insuring exposures, which require the buyer to establish reserves, thereby facilitating a deal.

There are many important insurance-related issues that need to be addressed during the course of a merger or acquisition. The summary above is a starting point, but may be only the “tip of the iceberg.” In order to help avoid post-acquisition problems, which can sour any deal, both the buyer and seller should understand and address these issues before and during the transaction, rather than after completion.

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should be covered and resort to a “proximate cause” analysis is unnecessary. Additionally, the OIL form explicitly covers “sue and labor” expenses. The policy requires insurer’s to reimburse such mitigation expenses “to the extent reasonably incurred arising from an occurrence covered hereunder.” It also requires that its subscribers take action in order to reduce or

prevent damage from impending natural disasters. Since OIL and any commercial carrier or underwriter that follows this wording benefits from the policyholder’s actions to lower the insurers liability, the insurers are responsible for these costs. Courts have recognized that policyholders that save the insurance companies from greater losses should be rewarded. As a result, they have ruled that such expenditures must be paid above and beyond the limits of the policy.

Finally, the OIL policy also contains a specific provision regarding how the definition of occurrence applies to losses from a hurricane. According to the definition, Condition “C,” each hurricane is considered “one

accident, event or cause” As a result, one limit applies but also only one deductible applies.

Policyholders are advised to review their policies as soon as possible, assess losses and tender notice where necessary. Corporate executives, boards of directors and shareholders have a right to make sure insurers are held to their promises to provide coverage. Insurers must do their part to pay their fair share of the losses. If the insurance industry or some segment of it decides, on the other hand, to fight rather than pay, the energy industry should be ready to take them on.

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v. Hartford Life Insurance Co., filed March 2004 (N.D. Ohio); *TransWorld Entertainment Corp. v. Hartford Life Ins. Co.*, filed October 2004 (N.D. Ohio.) The IRS has challenged some corporations' attempt to deduct policy loan interest payments under the technical requirements of the tax code and regulations. (*Winn-Dixie Stores, Inc. v. C.I.R.*, 113 T.C. 254

Ins. Co., 2003 WL 21696185 (D.N.H. July 11, 2003); *Lewis v. Wal-Mart Stores, Inc.*, No. 02-CV-944-EA (M)(N.D. Okla. Dec. 18, 2002).) All of these cases are in the courts now and will likely be litigated over the next several years.

Even though COLI has been one of the many funding mechanisms used by corporate entities, changes in

laws and regulations have been and will continue to change as employment and other relationships change. This means that review of current and past funding choices is essential to determine if any changes in substance or procedure are needed. COLI, like other long term investments and programs, must be reviewed regularly to make certain that the investment or program still meets

Some employees or former employees have even sued their employers claiming that the company had no right or ability to cause an insurance policy to be issued on their lives and that the proceeds of any benefits should go directly to them and not to the company to fund benefits in general.

(1999), *aff'd*, 254 F.3d 1313 (11th Cir. 2001); *In re CM Holdings, Inc.*, 254 B.R. 578 (Bankr. D. Del. 2000), *aff'd*, 301 F.3d 96 (3d Cir. 2002); *AEP, Inc. v. United States*, 136 F.Supp. 2d 762 (S.D. Ohio 2001), *aff'd*, 326 F.3d 737 (6th Cir. 2003); *Dow Chemical Company v. United States*, 250 F.Supp. 2d 748 (E.D. Mich. 2003).) Some employees or former employees have even sued their employers claiming that the company had no right or ability to cause an insurance policy to be issued on their lives and that the proceeds of any benefits should go directly to them and not to the company to fund benefits in general. (*Mayo v. Hartford Life Ins. Co.*, 354 F.3d 400 (5th Cir. 2004); *Rice v. Wal-Mart Stores, Inc., et al.*, WL 22240349 (D.N.H. Sept. 30, 2003); *Tillman v. Camelot Music, Inc.*, No. 02-CV-0761-EA (J)(N.D. Okla. Sept. 29, 2003); *Keenan v. AIG Life*

employment relationships of the last two decades are causing companies to shift from defined benefit plans and obligations to defined contribution and stock option benefits and to face new challenges to determine how best to fund these benefits and obligations. COLI may not be able to perform the same function in this new environment. As a result, companies may not be able to shift their risk to insurance companies for these obligations. Whether this will cause companies to stop or limit previously given benefits is not yet known. Other financial instruments, the tax code, and the competitive employee benefits marketplace will determine whether COLI or something else will be the method of choice to fund these obligations.

Companies using COLI must remember that federal and state

the original goal and needs and complies with any new developments in the law.

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Howrey Insurance In the News

Speaking Engagements

On June 17, 2005, **Mary Craig Calkins** (Los Angeles) spoke at the American Conference Institute about Directors and Officers liability issues. In October 2005, **Mary Craig Calkins** also spoke about D&O insurance issues at a Woodruff-Sawyer client seminar and a Woodruff-Sawyer broker seminar. The topics were “Rescission, Severability, and Practical Steps to Minimize D&O Coverage Disputes” and “Rescission, Severability, and Coverage Denial Arguments.”

On April 26, 2006, **Ty Childress** (Los Angeles) will be speaking at the Annual RIMS conference re: practical guidance on understanding and maximizing rights under contractual liability and additional insured coverage.

Awards and Honors

Joanne Caruso (Los Angeles) was named one of California’s Top 75 Women Litigators in 2005 by the *Los Angeles/San Francisco Daily Journal*.

Patrick McDonough (Los Angeles) was elected as Chair of the Institute for Corporate Counsel (ICC) and re-elected to a 3-year term on the board of governors. ICC is a Los Angeles-based non profit organization that provides an annual CLE seminar for inside counsel and outside counsel who advise corporations. It is co-sponsored by the Los Angeles Bar Association’s Corporate Law Departments Section and the USC Law School.

Published Articles

Lester Brown (Los Angeles), “The Oil Insurance Limited Policies: Broad Hurricane Loss Coverage,” *OilAndGasOnline.com*, (October 21, 2005).

Lester Brown (Los Angeles) and **Peter Fitzpatrick** (London), “Certain Expenditures Made to Protect Property and Minimize Damage From Storms Like Katrina and Rita May Be Covered Under A Marine or Oil Risk Property Insurance Policy,” *The Chemical Engineer/TCE Today*, (November 2005).

Mary Craig Calkins (Los Angeles), “Five Key Questions To Enhance D&O Insurance Coverage,” *Directors and Boards, Annual Director’s Guide to D&O Insurance*, (Winter 2005).

Mary Craig Calkins (Los Angeles), “D&O Liability Insurance: Rescission, Severability And A Checklist To Maximize Coverage,” *The Review of Securities & Commodities Regulation*, (September 2005).

Mary Craig Calkins (Los Angeles), “Policyholders’ Checklist to Avoid Rescission and Increase D&O Protections,” *American Conference Institute’s 11th Annual D&O Liability Insurance Conference*, (June 17, 2005).

Patrick McDonough (Los Angeles), “Insurance Brokers: The Growing Role of Corporate Counsel,” *Corporate Counselor*, (Spring, 2005).

News Coverage

Lester Brown (Los Angeles), “Insurers Squeezed After Katrina Floods,” *CBSMarketWatch.com*, (September 27, 2005).

Peter Fitzpatrick (London), “Class Litigation Spreads to Europe,” *Los Angeles Daily Journal*, (September 7, 2005).

Patrick McDonough (Los Angeles) “Solid Response to Marsh Settlement Fund: About 75% of Clients, by Dollar Value, Sign Up in Spitzer Pact,” *CBSMarketwatch.com*, (September 23, 2005).

Terrorism Coverage: TRIA Extended with Key Changes

by Ty R. Childress



In late December 2005, less than two weeks before the Terrorism Risk Insurance Act (“TRIA”) was set to expire, Congress extended TRIA another two years under the Terrorism Risk Insurance Revision Act of 2005 (“TRIRA”). Among the various uncertainties and ambiguities in the new legislation, there are two important changes that must be evaluated by policyholders with TRIA coverages:

(1) The exclusion of certain lines of coverage from TRIA protection.

(2) An increase in the loss size required to invoke TRIA protections.

Exclusions

Certain lines of insurance are excluded from TRIA protections, including commercial auto coverage, professional liability, and group life insurance. Although the two most exposed lines of coverage – property and liability – continue to be included under TRIA, property insurers are not required to cover nuclear, biological, chemical, and radiation exposures. Policyholders also need to remember that TRIA, in both its current and new form, does not cover “domestic” acts of terrorism (i.e., Oklahoma City), only acts of terrorism “committed by someone acting on behalf of a foreign person or interest.” Thus, potential ambiguities arise under TRIA as to whether, for example, an act of terrorism committed by an Islamic extremist group of US citizens based in the US would constitute an act on

behalf of a “foreign person or interest.” Policyholders should evaluate the nascent, but rapidly developing, market for contingent coverage for terrorism losses otherwise excluded under policies as outside TRIA protections.

Higher Retentions

In TRIRA 2005, Congress also increased the amount the insurance industry would have to satisfy before it would be able to seek recovery under TRIA. Those amounts are \$50 million in 2006 and \$100 million in 2007. As a result, this could mean that policyholders with typical TRIA coverage endorsements may not have coverage for “smaller” terrorism events. There are other insurance products/



markets (such as London’s T-3 coverage) which may be available to fill those potential gaps. Policyholders should carefully monitor how the insurance industry reacts to these increased retention levels and should seek confirmation from their insurers as to the impact, if any, the modified renewal of TRIA will have on their current coverage. For example, many policies continue terrorism coverage endorsements that purport to eliminate coverage if TRIA is not “renewed.” While it would be unreasonable to claim that Congress’ passage of TRIRA does not reflect a clear

intent to “renew” TRIA, policyholders should insist upon written confirmation from their insurers.

Long Term Outlook

In the aftermath of the tragic events of September 11, 2001, TRIA was created as a three-year program under which the federal government effectively reinsured terrorism losses up to certain limits and, in return for this financial protection, insurers were required to offer terrorism coverage. At the time, there was general consensus among lawmakers that such a temporary subsidy was necessary to ensure that terrorism coverage was available at all and to allow time for a private market to develop to insure those risks. However, as time has past, a number of lawmakers have insisted that continuing TRIA in its original form was serving as a bailout to the insurance industry and impeding the development of a private market-based solution. Absent a dramatic change in the political landscape or another terrorist-related loss, it is clear that TRIA is not likely to continue to be extended indefinitely. In the long term, policyholders with significant terrorism risks should evaluate the nascent, but rapidly developing, market for contingent coverage for terrorism exposures, especially those excluded under policies as outside TRIA protections, such as acts of domestic-inspired terrorism and nuclear and biological risks.

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