

# RISK

LEGAL ISSUES IN  
INSURANCE  
COVERAGE



NEWSLETTER

SUMMER 2004

## IN THIS ISSUE

### “UNILATERAL” RESCISSION? NOT SO FAST

Tips for protecting policyholders when insurers use “unilateral” rescission to avoid defense obligations under a D&O policy.....page 1

### RECENT DEVELOPMENTS IN THE LONDON MARKET

With an increasing percentage of Comprehensive General Liability insurers insolvent or in financial distress, understanding the London Market and its claims process is vital to maximizing recoveries.....page 2

### MAXIMIZING COVERAGE FOR YOUR MOLD CLAIM

Is there insurance for mold damage? .....page 4

### NEW ISO ENDORSEMENTS

The new ISO endorsements put coverage for additional insureds and indemnitors at risk.....page 6

## ALSO FEATURED

INSURANCE COVERAGE CASE  
HIGHLIGHTS.....page 8

### HOWREY INSURANCE NEWS & EVENTS

Recent Articles, Publications & Media  
Appearances.....page 11

Recent Speaking Engagements  
.....page 11

CONTACT US.....back page

## “UNILATERAL” RESCISSION? NOT SO FAST

by Andrew M. Reidy and Catherine J. Serafin



With the recent rise in cases involving corporate responsibility, it is essential that corporations have a clear understanding of the coverage afforded to them under their Directors and Officers (D&O) policies. D&O policies typically have either a duty to defend or a duty to pay defense costs. It is widely recognized that these insurance company duties are determined by comparing the allegations in the claim against the policyholder with the terms of the insurance policy. If there is a potential that the allegations may fall within coverage, the insurer has a duty to defend or to pay defense costs.

One argument frequently asserted by insurers to avoid their defense obligations is rescission or “unilateral” rescission (collectively “rescission”), a defense by which insurers attempt to extinguish the policy by declaring it void *ab initio*. In 2004, the majority of courts considering the rescission defense rejected it, or deferred consideration of rescission while ordering the insurer to fulfill its defense obligation. See, for example, the following cases:

- *In re HealthSouth Corp Ins. Litig.*, Consolidated Case No. CV-03-BS-1139-S (N.D. Ala. Mar. 16, 2004) (*HealthSouth*).
- *Federal Ins. Co. v. Tyco Int’l Ltd.*, Index No. 600507/03 (N.Y. Sup. Ct. Mar. 5, 2004) (*Tyco*).
- *Associated Electric & Gas Ins. v. Rigas*, 2004 WL 5440451 (E.D. Pa. Mar. 17, 2004) (*Rigas*).
- *ProNet Global Ass’n v. United States Liability Ins. Co.*, CV 396-J-32 TEM (M.D. Fla. Mar. 8, 2004).

continued page 7



# RECENT DEVELOPMENTS IN THE LONDON MARKET: HOW TO REALIZE MEANINGFUL VALUE FROM INSOLVENT COVERAGE

by Daniel E. Chefitz



An increasing percentage of Comprehensive General Liability (CGL) insurers are insolvent or in financial distress. In light of this trend, policyholders must consider how best to maximize the value of their insolvent coverage before bar dates (deadlines for filing claims) preclude making future claims.

Most historic programs include London Market coverage, and many of the companies that participated in the London Market are in some form of runoff. At the end of 2002, a KPMG LLP (UK) and AM Best study found that the UK run-off market had \$59.2 billion in total liabilities comprising approximately 28% of the total liabilities of the UK non-life insurance market.

A number of insolvent London Market Companies are contemplating early closure of their schemes of arrangement. Creditors of the insolvent London Market KWELM insurance companies (consisting of Kingscroft Insurance Company Limited, Walbrook Insurance Company Limited, El Paso Insurance Company Limited, Lime Street Insurance Company Limited, and Mutual Resinsurance Company Limited) voted in favor of early closure for the KWELM runoff scheme of arrangement. The KWELM scheme – which has a September 29, 2004, bar date – will distribute more than \$3 billion to insureds and may pay as high as 76 cents on the dollar before its liquidation.

OIC Run-Off Limited, another insolvent London Market Scheme consisting of The Orion Insurance Company (OIC) and The London and Overseas Insurance Company (L&O), recently announced its intention to seek early closure, which would require policyholders to submit claims before a final expected bar date of May 31, 2005. The OIC Scheme is currently paying 45 cents on the dollar for claims under most policies and 100 cents on the dollar under policies issued after ING became the ultimate parent of OIC and L&O.

## MAKING SENSE OF THE LONDON MARKET

Many policyholders find their London coverage confusing, with strange names or initials and percentages scribbled on slips of paper. Rest assured that there is logic and order to this apparent madness. Most London policies include coverage issued by Lloyd's through various numbered syndicates and from insurers outside of Lloyd's, known as London Market Companies, that participate as part of an underwriting pool. Each syndicate and London Market Company subscribes to a risk on a several, not joint, basis; thus insureds must seek payment from each company. Equitas reinsures and manages the runoff of all of the Lloyd's syndicates' pre-1993 non-life insurance and reinsurance liabilities, which are estimated at \$11-12 billion.

Insolvent London Market Companies operate under a scheme of arrangement, which is a corporate reorganization plan governed by the UK Companies Act. In the UK, insurers are first placed in a period of provisional liquidation under which agreed claims are paid at a reduced rate, rather than immediately being placed into full

*continued page 3*

liquidation. The scheme of arrangement process may become more prevalent among domestic insurers; Rhode Island recently became the first state to enact a scheme of arrangement type statute, perhaps prompting Stonewall Insurance Company to redomicile to Rhode Island.

There are two types of schemes of arrangement. In a **runoff scheme**, policyholders' claims are processed in the same manner as with an ordinary solvent insurer. Once a claim value is agreed upon, the policyholder becomes a creditor of the scheme and is paid a portion of its claim based on the set scheme payout percentage. Typically, the scheme's payment percentage will increase over time as the administrators perform periodic reviews of the scheme's assets and liabilities. In the UK, reinsurers must pay insolvent insurers the full amount of an agreed-on claim, even though the insolvent insurer will pay only a discounted portion of that claim to the insured. The difference goes into the pool of recoveries to be distributed to all policyholders.

In a **valuation scheme**, there is one fixed date, known as a bar date, by which policyholders are required to submit claims for all present and future liability under their policies, resulting in an effective commutation with all policyholders. Once the insurer and the policyholder agree on the value of the claims, the scheme will pay the claims according to the set payment percentage, with the possibility of a further dividend when all the remaining assets of the company are distributed.

Currently, there are approximately 20 London Market Companies in a valuation scheme, and 17 in a runoff scheme, with the remainder in liquidation. The average payout percentage of the runoff and valuation scheme companies is approximately 50%, with some companies paying as much as 100% for certain categories of claims. In addition, approximately 27 solvent runoff UK and other foreign insurance companies also operate under a scheme of arrangement.

## SETTLING YOUR LONDON MARKET COVERAGE

Before initiating settlement negotiations with the London Market, policyholders need to decide whether to buy back their London coverage, release certain coverages, or release only a narrow set of claims. Policyholders should weigh the uncertainty of future claims with the current financial status of particular London Market Companies and should also consider the presence of claims by competing insureds under the same London policies. For valuation schemes, policyholders must value and submit all possible claims under the coverage because the bar date will preclude any further claims.

Policyholders should keep the following key points in mind when developing a plan to maximize London Market recoveries.

### 1. KNOW YOUR COVERAGE PROGRAM

Identify all participating London Market Companies by name, limits, and layer of coverage. Determine the financial status of each insurer and all applicable bar dates or other deadlines. Never assume that you will receive notice of bar dates. Analyze how the terms and conditions of your solvent coverage address the unavailability of coverage in the same or underlying layers due to insolvency. Understand how potentially applicable jurisdictions treat insolvent coverage.

### 2. ANALYZE AND MODEL YOUR CLAIMS DATA

Be prepared to present future claims estimations that maximize the net present value. Estimation of future claims, referred to by the London Market as Incurred But Not Reported (IBNR), is a critical component to recovering the highest value from your London coverage. Scheme actuaries value IBNR using claims models developed by the London Market that, not surprisingly, result in low estimates. Insureds submit their own claims models with supporting data summaries to the scheme, and explain why such models more accurately reflect the insured's specific claims history.

*continued page 10*

# MAXIMIZING COVERAGE FOR YOUR MOLD CLAIM

by Ernest Summers



Molds are a type of fungi that can cause millions of dollars' worth of property damage and serious health problems, sometimes before the mold is even discovered. Some molds have been linked to triggering asthma attacks.

Molds grow from spores that can be found virtually anywhere. All the spores need is moisture and a food source and they can begin to grow. Much has been written concerning the legal problems stemming from mold, mildew, and other fungi. Some forms of mold are toxic, but most are not. Without question, there has been a proliferation of litigation over mold, and there is considerable debate among legal and medical experts over the consequences of mold growth.

Insurance companies are becoming increasingly concerned about liability for mold and have attempted to limit their liability in a variety of ways, including the creation of mold exclusions, the application of previously existing pollution exclusions and other exclusions, the creation of sub-limits of liability for mold claims, and other provisions. To date, the legislative, regulatory, and judicial responses have been mixed and are still evolving.

Those with mold problems face the question: Is there insurance coverage for mold damage? There is no universal answer; the fact is that some mold claims will be covered and others will not, depending on a variety of interrelated factual and legal issues. Policyholders faced with a mold problem should expect that their insurers will assert countless arguments in an attempt to defeat coverage. These arguments may be unfounded, though. A policyholder must be both diligent and persistent in the claims process or risk losing coverage that would otherwise be available.

A variety of insurance policies may provide coverage for mold claims, but obtaining coverage is dependent on the nature of the damage, its causes, and the injured parties or premises. A policyholder should consider whether the mold problem gives rise to a claim under its own first party property coverage, a contractor's insurance program, general liability coverage, workers' compensation, professional liability insurance, or other insurance.

## POTENTIAL INSURANCE CLAIMS TO INVESTIGATE

### *First Party Claims*

When mold damages property owned by the policyholder or injures the policyholder, there are a variety of first party policies that can provide coverage, including homeowners' policies, renters' coverage, commercial property coverage, builders' risk policies, and other policies. The language of the policies is not uniform; it can vary from state to state, but most modern policies contain some form of mold and/or pollution exclusion that the insurer will claim precludes coverage. The exclusion may or may not bar coverage for a given mold problem, and a policyholder must fully understand the facts, the policies, and the law before concluding whether or not there is coverage.

The insuring agreements for such policies typically provide that the insurer will pay for direct physical loss from covered perils or for damage to property arising from a covered peril. The policies can be all-risk policies or they can be specified peril policies. Whether mold damage is covered can seem like a chicken-and-egg proposition; the insurers are likely to argue that mold damage is not a covered peril and any consequences are similarly not covered. On the other hand, if the damage is caused by a covered peril (e.g., roof leaks, wind-driven rain, accidental discharge from a plumbing system, etc.) and mold is the consequence of the covered peril, the policyholder has a better argument for coverage.

*continued page 5*

Courts have been inconsistent in applying the insuring agreements and exclusions to mold claims. It would be a mistake to assume that a given policy does or does not cover mold without understanding the relevant case authorities. Three important concepts to consider are the “wear and tear” exclusions, the “ensuing loss” doctrine, and “efficient proximate cause.” Some courts have enforced “wear and tear” exclusions to preclude coverage for mold naturally occurring over time as a result of high humidity and other general climatic conditions. In other words, there is no single covered event that can be said to be the cause of the mold. This is a very fact-specific analysis. If a mold claim is made under a policy with a “wear and tear” exclusion, the policyholder should be prepared to offer proof of a covered peril that resulted in the mold. Some courts have found coverage for mold damage where the damage is an ensuing loss of a covered peril, even where there is a specific mold exclusion in the policy. Other courts relied upon the doctrine of efficient proximate cause to find coverage for mold despite mold exclusions in the policies at issue. In such cases, whether there is coverage for mold will depend on a factual showing that the efficient proximate cause of the mold is a covered peril rather than an excluded peril such as wear and tear.

### **Third Party Liability Claims**

Mold can also result in liability to third parties and implicate liability policies. As is the case with first party coverage, the specific language of liability policies varies, and it is necessary to understand the specific terms of the policies in question. The insuring agreements of liability policies typically provide that the insurance company will pay “all sums the insured becomes legally obligated to pay as damages” or that it will reimburse the ultimate net loss sustained by the policyholder. Like first party coverage, third party liability coverage can contain numerous exclusions, including mold exclusions, pollution exclusions, and owned-property exclusions.

The law regarding the applicability and enforceability of mold exclusions in liability policies is unclear at this time. In policies that do not contain specific mold exclusions, insurers have asserted that pollution exclusions bar coverage, relying by analogy on indoor air quality cases that involved lead paint, carbon monoxide, and other contaminants. There are countless cases both in favor of coverage and restricting coverage for policyholders and insurers to cite by analogy to pollution cases. For now, the law is unsettled, and policyholders faced with mold issues should take steps to maximize the

potential for insurance coverage for their claims. That is why it is important for a policyholder to get a prompt evaluation of both the nature of the mold problem and the insurance policies that may provide coverage.

### **FIVE CRITICAL STEPS TO MAXIMIZE INSURANCE COVERAGE FOR MOLD**

1. Understand the facts and the nature of the mold damage/liability. Take mold damage seriously and hire an expert, if necessary, to determine the cause of the mold and whether it occurred gradually over long periods of time.
2. Identify and collect ALL of your insurance policies. Multiple policies may be implicated, and they may contain substantially different provisions.
3. Review the policy provisions carefully. Read your insuring agreements and exclusions carefully. Understand your deadlines for submitting claims and proofs of loss, and for filing suit. Understand your policies’ suit limitations provisions, which can involve deadlines materially shorter than those in statutes of limitations, and understand whether appraisal, arbitration, or other alternative dispute resolution is required prior to litigation.
4. Give written notice to all potentially implicated insurers as soon as you are aware of a potential claim. Err on the side of giving notice, even if a policy arguably does not apply. Many valid insurance claims have been lost because there was late or no notice of the claims.
5. Keep a record of all insurance notice correspondence and claims-handling communications. Document all oral conversations with your insurer. Keep records of activities undertaken by your insurer, including dates, the names of the insurer representatives involved, requests for any follow-up information, and so on. Be diligent and persistent. If you end up in litigation, you will want a clear record of the insurer’s handling of your claim. Such a record may lead to a bad faith claim against the insurer. ■

*Ernie Summers is a Partner in the Chicago office of Howrey Simon Arnold & White. He can be reached at [SummersE@howrey.com](mailto:SummersE@howrey.com).*

# NEW ISO ENDORSEMENTS PUT COVERAGE FOR ADDITIONAL INSUREDS AND INDEMNITORS AT RISK

by Tyrone R. Childress



Earlier this year, the Insurance Services Office, Inc. (ISO), which drafts form policy provisions used widely by the insurance industry, introduced substantially revised standard additional insured endorsements, as well as an endorsement revising the definition of “insured contract.” Although ISO claims that these new endorsements are meant to “better reflect the intent” behind additional insured coverage, the endorsements are a substantial restriction on traditional coverage afforded both additional insureds and indemnitors.

The current ISO additional insured endorsements provide coverage for liability of the additional insured “arising out of” the named insured’s operations. The majority of courts consistently have interpreted the phrase “arising out of” to include the additional insured’s sole negligence, so long as there was at least some connection between the injury and the named insured’s work on behalf of the additional insured. ISO’s new endorsements seek to limit substantially that traditional scope of coverage by injecting a “fault-based” analysis. Under the new endorsements, the additional insured would have coverage only if the injury or damage is also caused at least in part by the named insured’s acts or omissions. In order to trigger coverage, the additional insured is now incentivized to develop facts and legal theories to show liability on the part of the named insured. Contrary to insurers’ fiduciary obligations to their insureds, this new requirement has the potential to pit insureds against each other.

Of perhaps even greater concern to policyholders is ISO’s alternative definition of “insured contract.” For decades, indemnitors have relied on their contractual liability coverage to respond to their indemnity obligations. Outside of the construction setting, most states allow parties to indemnify even for the sole negligence of the indemnitee. ISO’s new definition would eliminate coverage for any indemnity obligation for the indemnitee’s sole negligence. Under this endorsement, an indemnitor and an indemnitee could enter into a completely valid indemnity agreement encompassing sole negligence, and yet the indemnitor’s coverage will not respond as it has for decades. This potential coverage “gap” will create problems for both indemnitors (who have relied on coverage for their indemnity obligations) and indemnitees (who count on indemnitors to have insurance assets for those obligations).

Because insurers are not required to replace the existing additional insured endorsements and “insured contract” definitions with these new more restrictive forms, policyholders armed with the understanding that these new endorsements may impact their coverage should seek to negotiate these issues with their insurers rather than idly accepting these new forms. ■

*Ty Childress is a Partner in the Los Angeles office of Howrey Simon Arnold & White. He can be reached at [ChildressT@howrey.com](mailto:ChildressT@howrey.com).*

## SUGGESTIONS & COMMENTS

We welcome your feedback and suggestions. Please feel free to let us know if you would like us to address a specific topic in a future issue of *RISK*.

Contact Cheryl Handel at 213-892-1926 or [HandelC@howrey.com](mailto:HandelC@howrey.com).

In *HealthSouth*, several insurers sought to rescind coverage under D&O policies and fiduciary liability policies for the former officers and directors of HealthSouth. The insurer relied, in part, on guilty pleas entered by former HealthSouth officers who admitted that they participated in a scheme to alter the company’s financial reports. Op. at 3. The court held that the particular severability clauses in the policies in that case “preclude rescission as to all insureds regardless of their involvement in the alleged fraud.” Op. at 5. In so holding, the court rejected Federal Insurance’s attempt to rely on representations contained in HealthSouth’s financial statements, finding that, if the insurers “can rescind coverage because of misstatements or misleading statements in HealthSouth’s SEC filings, without showing that the individual insured knew of the misstatement, then coverage under the D&O policies would be totally illusory.” Op. at 52-53.

Similarly, in *Tyco*, Federal Insurance filed an action against Tyco and its directors and officers, seeking a declaration confirming that Federal Insurance had unilaterally rescinded the D&O policy it sold to Tyco. Dennis Kozlowski, Tyco’s former CEO, sought a ruling that Federal Insurance was obligated to pay for the defense of an ERISA case, a securities action, and a criminal prosecution. The trial court granted Mr. Kozlowski’s motion for partial summary judgment on the duty to defend, reasoning that, “until Federal’s rescission claims are litigated in its favor and the Policies are declared void *ab initio*, they remain in effect and bind the parties.” Op. at 8. The court also held that “Federal’s unproven rescission claim does not affect its present obligation to defend Kozlowski or pay his defense costs under the Policies.” *Id.* at 9.

Not every recent case has reached the same result. A contrary result was reached in *Cutter & Buck Inc. v. Genesis Ins. Co.*, 2004 WL 405958 (W.D. Wash. Feb. 11, 2004). In *Cutter & Buck*, the insurance company unilaterally rescinded a D&O policy based on alleged misrepresentations in the application. The trial court held that rescission was warranted because there were material misrepresentations made with the intent to deceive. The trial court adopted a very narrow construction of the severability provision in the policy and held that it did not protect the innocent directors

and officers. The court stated that, “when the signor knows that there are misrepresentations in the application materials, that knowledge is imputed to all other directors and officers.” 2004 WL 405958 at 21.

## SOME GENERAL OBSERVATIONS

A survey of rescission cases favorable to policyholders demonstrates the following points:

- Severability provisions in the policies often prohibit the insurer from rescinding the policy as to individual insureds (see *HealthSouth*).
- Rescission is not a self-executing event that automatically vitiates the duty to defend. In many states, there must be a judicial determination before the insurer can escape its duty to defend (see *Tyco, Rigas*).
- Rescission may not succeed if the policyholder can show waiver, estoppel, or ratification (see, e.g., *Utah Power & Light Co. v. Fed. Ins. Co.*, 983 F.2d 1549, 1554-56 (10th Cir. 1993); *Union Ins. Exch. Inc. v. Gaul*, 393 F.2d 151, 154-55 (7th Cir. 1968)).
- Cancellation provisions in the insurance contract or state statutes may pre-empt common law rescission claims (see, e.g., *Wisconsin Hous. & Econ. Dev. Auth. v. Verex Assurance, Inc.*, 464 N.W.2d 10, 13-14 (Wis. Ct. App. 1990), *aff’d*, 480 N.W.2d 490 (Wis. 1992)).
- Rescission may not apply if third party claims are pending (see, e.g., *Douglass v. Nationwide Mut. Ins. Co.*, 913 S.W.2d 277, 281-83 (Ark. 1996); see also *Ingrassia v. Medical Malpractice Ins. Ass’n*, 161 A.D.2d 685, 686-87, 555 N.Y.S.2d 876, 877 (2d Dept. 1990)).
- A policy may not be rescinded in part (*HealthSouth*). A successful rescission defense is premised on the principle that the entire policy is void *ab initio* due to misrepresentations. Thus, insurers may not rescind a policy as to some insureds, but not all insureds.

continued page 10

# INSURANCE COVERAGE CASE HIGHLIGHTS

by Julie S. Zimmerman



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.

## NEW YORK

*IBM v. Liberty Mutual Ins. Co., et al.*, 363 F.3d 137 (2d Cir. 2004)

In *IBM*, the United States Court of Appeals for the Second Circuit, following New York law, affirmed the judgment of the United States District Court for the Southern District of New York declaring the trigger of liability coverage to be the last date of each employee’s exposure to the cause of injury while employed by plaintiff policyholder. The court held this despite a stipulation in the underlying negligence and strict liability action that withdrew claims for damages or wrongdoing after a date certain occurring before the exposure ended.

At issue in the appeal was the duty of the insurers who issued employers liability and workers compensation coverage for IBM’s California manufacturing facilities. The claim for coverage involved toxic tort suits commenced in 1998 by dozens of current and former IBM employees who alleged that they contracted cancer by working in IBM’s California “cleanroom” facilities. The policies at issue contained a “last exposure” trigger, which, as the court noted, is a rule of convenience that contemplates the situation in which an employee has been exposed to the hazards of occupational disease while employed by more than one employer, or covered by more than one policy. The court further noted that a defining characteristic of the “last exposure” trigger is that only one policy and policy year can be triggered for any employee claim – the policy in effect on the employee’s last day of last exposure to substances causing the disease.

The insurers disclaimed coverage on the grounds that the trigger of coverage in the relevant policy years was a claimant’s last day of exposure to cleanroom conditions

at IBM, and that by virtue of the stipulation entered into between IBM and the employees, which limited the scope of the employees’ claims to injury suffered as a result of cleanroom exposure prior to January 1, 1983, the 1982 insurance contract was the one policy that was in force on the last day of last exposure. The insurers further argued that there was no coverage for the underlying suits because none were commenced within three years after the end of the 1982 policy, as required by the terms of that policy.

In contrast, IBM argued that the insurers owed a duty to defend each claim under the policy in force on each claimant’s last day of exposure and that, absent evidence to the contrary, the last day of exposure was a plaintiff’s last day of employment with IBM. Because the stipulation did not allege the plaintiffs’ last day of exposure, IBM argued that the last date of employment specified by the plaintiffs in their interrogatories (ranging from 1977 to 1999) implicated coverage under subsequent insurance policies that contain no claims-made exclusions.

The district court agreed with IBM. Although the court made no finding as to the last day of exposure for each California plaintiff, it noted that setting the particular day was a factual determination, which “in the absence of other evidence is the last day of employment of each plaintiff.” The court further noted that each plaintiff’s last day of exposure might ultimately be resolved between the parties or by a trier of fact. It was clear, however, that the stipulation did not affect the policies’ trigger mechanism, or the factual determination upon which its operation was predicated.

As stated above, the Second Circuit agreed with the lower court, finding that the trigger of liability coverage is

the last date of each tort plaintiff's exposure to the cause of injury (while employed by IBM) notwithstanding the stipulation in the underlying litigation that withdrew any claim for damages and any claim of wrongdoing after December 31, 1982 (a date after which many tort plaintiffs' exposure appeared to have long continued). Thus, the court agreed that the trigger of coverage as to each claim is each claimant's last day of last exposure – which is the last day of employment in IBM's California cleanroom facility.

## VIRGINIA

*St. Paul Fire & Marine Ins. Co. v. American International Specialty Lines Ins. Co., et al.*, 2004 U.S. App. Lexis 6952 (4th Cir. April 9, 2004)

In *St. Paul*, the U.S. Court of Appeals for the Fourth Circuit found that an indemnity agreement or an indemnity clause may control the allocation of liability among multiple insurers irrespective of any "other insurance" clauses found in the policies.

The underlying lawsuit sought damages for alleged food poisoning suffered by the plaintiff while a guest at the insured resort. The resort owner was insured under a primary policy by CNA and an umbrella policy by AISLIC. The resort's management company obtained primary coverage through St. Paul and umbrella coverage through TIG. The insurers agreed to settle the action for \$4 million, \$3 million of which was funded through an interim agreement among three insurance companies. The three insurers agreed to resolve their coverage and allocation issues after the underlying lawsuit settled.

Subsequently, one of the settling insurers, St. Paul, filed suit against the other two settling insurers, CNA and AISLIC, and also against TIG, which did not contribute to the settlement. St. Paul sought a declaration of the four insurers' respective liability in connection with the settlement. St. Paul sought to recover the \$1 million it had contributed, arguing that it had no obligation to cover any portion of the settlement. The district court, following Virginia law, granted AISLIC's motion for summary judgment and denied St. Paul's motion for summary judgment. The court also ordered TIG to pay \$1 million toward the underlying settlement.

The Fourth Circuit reversed the district court's judgment, concluding that CNA and AISLIC were obligated to cover the entire settlement amount. The

case was remanded with instructions to enter summary judgment in favor of St. Paul and in favor of TIG. The appellate court also directed the district court to order AISLIC to reimburse St. Paul for the \$1 million St. Paul had already paid toward the settlement. AISLIC was also to pay the \$1 million for which TIG was erroneously held to be responsible.

In reaching its decision, the Fourth Circuit noted that the general rule is that "an indemnity agreement between the insureds or a contract with an indemnification clause may shift an entire loss to a particular insurer notwithstanding the existence of an 'other insurance' clause in its policy." Thus, the appellate court held that the indemnification provision in the management agreement between the management company and the resort owner controlled the allocation of liability among the insurers.

In addition, the appellate court noted that most, if not all, jurisdictions that have faced the question of whether an indemnification agreement could relieve particular insurers of an obligation to pay, without resort to a separate action to enforce the indemnification agreement, have answered in the affirmative. Thus, the appellate court predicted that the Supreme Court of Virginia would conclude, like the majority of other jurisdictions, that the indemnification obligations should be considered before responsibility is allocated for the settlement liability according to the terms of the relevant policies. ■

*Julie Zimmerman is a Senior Associate in the Los Angeles office of Howrey Simon Arnold & White. She can be reached at ZimmermanJ@howrey.com.*

---

***“More a vehicle for Jesuitical or Talmudic debate than a definition of the rights and obligations of the parties to the contract, the policy crosses one's eyes and boggles one's mind.”***

*Columbia Casualty Co. v. Northwestern National Ins. Co.*, 231 Cal. App. 3d 457, 470 n. 20 (1991)

---

### **3. PREPARE FLEXIBLE ALLOCATION MODELS**

Always assert that your claims impair the full available limits of the applicable London Market policies. To support impairment of all London Market limits, prepare aggressive, yet reasonable and flexible, allocation models. Models need not be tied to the law of any particular jurisdiction, and may incorporate alternative allocation theories. The Scheme Administrators are more likely to negotiate with policyholders that present a model based on an apparent compromise allocation position, even if the models reach a result more beneficial to the policyholder.

### **4. BE PREPARED TO NEGOTIATE**

Policyholders are not required to accept the scheme's initial claims valuation, and should be prepared to negotiate with the scheme using alternative claims projections and allocation models. While the discount rate is typically set by the scheme documents, most other factors are negotiable. In many instances the negotiations

need not focus on legal issues and may resemble a business deal, as long as the insured can provide the scheme with a basis to support the final number for reinsurance purposes. In a recent case, we succeeded in increasing the Scheme Administrator's original \$3 million valuation to \$11.5 million using a combination of legal and business-based arguments. If an agreement cannot be reached, many schemes provide for a process to dispute the Scheme Administrators' valuation by presenting the written evidence before a Scheme Adjudicator for a binding determination, which cannot be appealed except in the case of "mathematical or manifest error." Because the Scheme Adjudicator has the discretion to order either party to pay the Scheme Adjudicator's costs and expenses, all effort should be made to reach a compromise settlement with the Scheme Administrators. ■

*Daniel Chefitz is Of Counsel in the Washington, D.C., office of Howrey Simon Arnold & White. He can be reached at [ChefitzD@howrey.com](mailto:ChefitzD@howrey.com).*

## **"UNILATERAL" RESCISSION? NOT SO FAST** (continued from page 7)

### **PRACTICAL TIPS FOR POLICYHOLDERS**

*Although recent case law has been favorable to policyholders, they should take several steps to further protect their interests.*

- BE VIGILANT DURING THE APPLICATION PROCESS. SEEK POLICY APPLICATIONS STATING THAT ANY REPRESENTATIONS ARE BASED ON "SUBJECTIVE" KNOWLEDGE.
- BARGAIN FOR STRONG SEVERABILITY PROVISIONS, AND PERHAPS PROVISIONS PROHIBITING RESCISSION ENTIRELY, OR UNDER SPECIFIED CIRCUMSTANCES ONLY.
- REJECT ATTEMPTS AT "UNILATERAL" RESCISSION. THE POLICYHOLDER SHOULD NOT CASH A RETURNED PREMIUM CHECK IN ORDER TO AVOID AN ARGUMENT BY A CARRIER THAT, BY ACCEPTING A RETURNED PREMIUM, THE POLICYHOLDER HAS WAIVED ITS RIGHT TO CONTEST THE RESCISSION.
- TAKING THE PRECEDING STEPS SHOULD HELP KEEP YOUR INSURANCE COVERAGE INTACT.

*Andrew Reidy and Catherine Serafin are partners in the Washington, D.C., office of Howrey Simon Arnold & White. They can be reached at [ReidyA@howrey.com](mailto:ReidyA@howrey.com) and [SerafinC@howrey.com](mailto:SerafinC@howrey.com).*

# HOWREY INSURANCE NEWS AND EVENTS

## RECENT ARTICLES, PUBLICATIONS & MEDIA APPEARANCES

**Yuri Mikulka's** article "A Disturbing Trend of Coverage Denials of Directors and Officers Liability Insurance" was published in the ABA Committee on Corporate Counsel newsletter, Winter 2004, and the Federal Bar Association newsletter, May 2004. In addition, she was interviewed in an article about rainmaking tips, "The Forecast Is for Rain," in *Litigation News* (published by the ABA Section of Litigation), March 2004.

**Andrew Reidy** and **Catherine Serafin** published an article in the May 2004 issue of *Insurance Coverage Law Bulletin*, "An Insurance Company's Rescission Defense Does Not Preempt the Insurer's Defense Obligation."

**Robert Shulman** and **David Steuber** are ranked among the top insurance recovery practitioners in the 2004 edition of *Chambers USA, America's Leading Business Lawyers*. ■

## RECENT SPEAKING ENGAGEMENTS

On June 1, 2004, **Ty Childress** spoke at the RIMS Orange County's monthly meeting on the topic "A Survival Guide for Additional Insureds: Avoiding Common Pitfalls and the New ISO Endorsements."

**Andrew Reidy** and **Catherine Serafin** were co-presenters with Tom Bentz and Chris DiLullo from Marsh at a seminar on May 12, 2004, on the topic "What You Don't Know About Your Directors and Officers Insurance." They also spoke to the Potomac Chapter of RIMS on March 17 regarding directors and officers coverage. Catherine Serafin was a guest lecturer on errors and omissions insurance coverage at the University of Connecticut School of Law on April 1, 2004.

**Helen Michael** gave a presentation at the ABA Litigation Section annual meeting on May 6, 2004, in Phoenix, entitled "Houston, We Have a Problem: Punitive Damages Control," a mock oral argument addressing new limitations on the award of punitive damages imposed by the U.S. Supreme Court's decision in *Campbell v. State Farm Ins. Co.*

On March 30, 2004, **Joanne Caruso** spoke at a program entitled "Video Depositions at Trial – Help or Hindrance" for the Los Angeles County Bar Association. The panel explored the pros and cons of videotaped depositions at trial, some of the limitations a trial judge may place on use of videos, and how to deal with those limitations. ■

# CONTACT US

## WASHINGTON, DC 202 783 0800

### PARTNERS

Robert H. Shulman, Co-Chair

[ShulmanR@howrey.com](mailto:ShulmanR@howrey.com)

Brent H. Allen

[AllenBrent@howrey.com](mailto:AllenBrent@howrey.com)

Mindy G. Davis

[DavisM@howrey.com](mailto:DavisM@howrey.com)

Robert P. Jacobs

[JacobsR@howrey.com](mailto:JacobsR@howrey.com)

Jeffrey M. Lenser

[LenserJ@howrey.com](mailto:LenserJ@howrey.com)

Helen K. Michael

[MichaelH@howrey.com](mailto:MichaelH@howrey.com)

Andrew M. Reidy

[ReidyA@howrey.com](mailto:ReidyA@howrey.com)

Robert F. Ruyak

[RuyakR@howrey.com](mailto:RuyakR@howrey.com)

Catherine J. Serafin

[SerafinC@howrey.com](mailto:SerafinC@howrey.com)

Koorosh Talieh

[TaliehK@howrey.com](mailto:TaliehK@howrey.com)

Peter L. Tracey

[TraceyP@howrey.com](mailto:TraceyP@howrey.com)

James R. Wagner

[WagnerJ@howrey.com](mailto:WagnerJ@howrey.com)

### OF COUNSEL

Daniel E. Chefitz

[ChefitzD@howrey.com](mailto:ChefitzD@howrey.com)

## SENIOR ASSOCIATES

Lara A. Degenhart

[DegenhartL@howrey.com](mailto:DegenhartL@howrey.com)

Donna M. Drake-Carlton

[DrakeD@howrey.com](mailto:DrakeD@howrey.com)

Kenneth N. Hickox

[HickoxK@howrey.com](mailto:HickoxK@howrey.com)

John F. Stanton

[StantonJ@howrey.com](mailto:StantonJ@howrey.com)

## ASSOCIATES

Christine S. Davis

[DavisChristineS@howrey.com](mailto:DavisChristineS@howrey.com)

Dennis L. James

[JamesD@howrey.com](mailto:JamesD@howrey.com)

Arden B. Levy

[LevyA@howrey.com](mailto:LevyA@howrey.com)

Nancy D. Tunis

[TunisN@howrey.com](mailto:TunisN@howrey.com)

## STAFF ATTORNEY

Linda A. Powell

[PowellL@howrey.com](mailto:PowellL@howrey.com)

## LOS ANGELES, CA 213 892 1800

### PARTNERS

David W. Steuber, Co-Chair

[SteuberD@howrey.com](mailto:SteuberD@howrey.com)

Lester O. Brown

[BrownL@howrey.com](mailto:BrownL@howrey.com)

Mary Craig Calkins

[CalkinsM@howrey.com](mailto:CalkinsM@howrey.com)

Joanne E. Caruso

[CarusaJ@howrey.com](mailto:CarusaJ@howrey.com)

Tyrone R. Childress

[ChildressT@howrey.com](mailto:ChildressT@howrey.com)

Amy J. Fink

[FinkA@howrey.com](mailto:FinkA@howrey.com)

Danielle L. Gilmore

[GilmoreD@howrey.com](mailto:GilmoreD@howrey.com)

Stephen V. Masterson

[MastersonS@howrey.com](mailto:MastersonS@howrey.com)

Patrick J. McDonough

[McDonoughP@howrey.com](mailto:McDonoughP@howrey.com)

Thomas M. McMahon

[McMahonT@howrey.com](mailto:McMahonT@howrey.com)

Curtis D. Porterfield

[PorterfieldC@howrey.com](mailto:PorterfieldC@howrey.com)

William T. Um

[UmW@howrey.com](mailto:UmW@howrey.com)

Susan Page White

[WhiteS@howrey.com](mailto:WhiteS@howrey.com)

## SENIOR ASSOCIATES

Vina Chin

[ChinV@howrey.com](mailto:ChinV@howrey.com)

Jeffrey M. Jacobberger

[JacobbergerJ@howrey.com](mailto:JacobbergerJ@howrey.com)

Kenneth A. Remson

[RemsonK@howrey.com](mailto:RemsonK@howrey.com)

Julie Shluker Zimmerman

[ZimmermanJ@howrey.com](mailto:ZimmermanJ@howrey.com)

## ASSOCIATES

Donald R. Erlandson

[ErlandsonD@howrey.com](mailto:ErlandsonD@howrey.com)

Celisa J. Morin

[MorinC@howrey.com](mailto:MorinC@howrey.com)

Charles K. Park

[ParkC@howrey.com](mailto:ParkC@howrey.com)

Eric C. Schaffer

[SchafferE@howrey.com](mailto:SchafferE@howrey.com)

Sandra Smith Thayer

[ThayerS@howrey.com](mailto:ThayerS@howrey.com)

## IRVINE, CA

949 721 6900

### PARTNER

Yuri Mikulka

[MikulkaY@howrey.com](mailto:MikulkaY@howrey.com)

## CHICAGO, IL 312 595 1239

### PARTNER

Ernest Summers III

[SummersE@howrey.com](mailto:SummersE@howrey.com)

### OF COUNSEL

Karen Poulos

[PoulosK@howrey.com](mailto:PoulosK@howrey.com)

## LONDON, UK

+44 (0) 20 7628 3303

### PARTNER

Peter J. Fitzpatrick

[FitzpatrickP@howrey.com](mailto:FitzpatrickP@howrey.com)

If you have any questions regarding this publication, please contact Cheryl Handel at 213-892-1926 or [HandelC@howrey.com](mailto:HandelC@howrey.com).



1299 PENNSYLVANIA AVE., NW  
WASHINGTON, DC 20004