JENNER&BLOCK

Insurance Litigation and Counseling Practice

Insurance Counselor

WINTER 2010

From the Editor:

Lorelie S. Masters

Dear Readers:

We are pleased to announce that Jerold Oshinsky has joined our practice group, continuing his policyholder practice in our Los Angeles office. Jerry is one of the premier policyholder coverage attorneys in the United States. With more than 30 years in the insurance coverage arena, his sought-after experience has touched numerous clients, including Fortune 100 companies, in a wide variety of industries–chemical, pharmaceutical, food, communications, education, financial, technology and construction industries.

Jerry brings additional depth to Jenner & Block's Insurance Litigation and Counseling Practice with his extensive cutting-edge work on matters including advertising liability, asbestos, broker's liability, business interruption, construction defects, directors and officers, employment and discrimination issues, environmental liability, errors and omissions, fidelity bonds, professional indemnity, general liability, intellectual property, products liability, and first-party property policies.

Lorie Masters

How to Avoid the Impact of a Warranty Letter—A Cautionary Tale

by Matthew L. Jacobs and Daniel I. Weiner

Policyholders seeking to obtain Directors & Officers ("D&O") and many other types of liability coverage are often confronted with the question of whether, apart from agreeing to the terms of the policy, they should also acquiesce to an insurer's request that they sign a separate warranty letter at the time of policy placement. If faced with such a request, a prospective insured should proceed with caution.

Rather than simply restating conditions in the policy, warranty letters are separate agreements that insurers often try to use to impose different, less favorable, conditions upon the insured. In most circumstances, insurers have no legitimate reason to request this type of separate agreement, when they are already protected pursuant to the policy's terms and conditions. That being said, even a policyholder who already has signed a warranty letter should be aware that an insurer's attempt to deny coverage based on the letter may still be improper based on core black letter insurance principles.

Background

The potential pitfalls of signing a warranty letter are illustrated by an October 26, 2009 decision from the Tenth Circuit, *Rivelli v. Twin City Fire Insurance Co. (Rivelli II)*.[1] The plaintiffs in *Rivelli* were directors and officers of a Colorado company, Fischer Imaging, that had purchased excess D&O coverage from Twin City, a large, established insurer.[2] The excess policy provided for two layers of coverage, each for $2.5 million. To obtain the second layer, sometimes called "top" coverage, Fischer not only paid an additional premium but also provided Twin City with a

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letter, signed by one of the *Rivelli* plaintiffs on May 1, 2002, titled "AN EXPRESS WARRANTY FOR ALL INSUREDS."[3] The letter contained what was, in effect, a relatively broad exclusion relating to the insureds' "prior knowledge," providing that "[n]o person or entity for whom this insurance is intended has any knowledge or information of any act, error, omission, fact or circumstance which may give rise to a claim which may fall within the scope of the proposed [top] insurance… "[4]

In April 2003, Fischer and other insureds were targeted by two shareholder actions, both of which were eventually dismissed.[5] But in June 2005 the Securities and Exchange Commission (SEC) filed a civil enforcement action alleging that the insureds had "engaged in a scheme to fraudulently inflate [Fischer's] stock price for their personal enrichment" from January 2000 to September 2002.[6] By that point, the insureds had run through their primary D&O coverage and the first $2.5 million of excess coverage. When the insureds submitted claims for the second $2.5 million, however, Twin City denied coverage entirely based on the exclusion for prior knowledge in the warranty letter.[7] Twin City argued, based on the allegations in the SEC's complaint, that certain insureds allegedly knew of wrongful activities at Fischer that could give rise to a claim reaching the top coverage at the time the warranty letter was signed.[8] These bare allegations, according to Twin City, were sufficient to bring the entire SEC enforcement action within the scope of the letter's exclusionary effect, thereby eliminating Twin City's defense obligation.[9]

Following Twin City's denial, the insureds brought an action for coverage in the U.S. District Court for the District of Colorado.[10] After cross motions for summary judgment, the district court ruled for Twin City. At the core of the district court's holding was its determination that the exclusion for prior knowledge in the warranty letter "was triggered by the allegations in the SEC's amended complaint that, when read together, show that plaintiffs Rivelli and Johnson knew of the wrongful acts at Fischer that could rise to a claim under the Twin City Policy before May 1, 2002."[11]

The Tenth Circuit's Decision

The insureds appealed. Among other things, they contended that, in granting summary judgment, the district court: 1) unreasonably construed ambiguous language in the warranty letter; 2) erroneously "construed alternative and contradictory allegations in the SEC's amended complaint as establishing that the claims were solely and entirely within the prior knowledge exclusion in the Warranty Letter"; 3) failed to acknowledge that the SEC's claims could be satisfied by "mere negligence" that would not trigger the exclusion in the warranty letter; and 4) erroneously held that the "existence of any allegation of fact raising an inference of knowing wrongdoing establishes a prior knowledge exclusion as a matter of law, and eliminates a duty to defend in its entirety."[12]

The Tenth Circuit rejected all of the insureds' arguments and affirmed the district court's ruling. The court of appeals did not agree that the language in the warranty letter was ambiguous.[13] The court of appeals also found that the insureds had failed to identify any actual inconsistent, contradictory or frivolous allegations in the SEC's complaint, and that "the district court correctly concluded that the SEC's claims, when read together, compelled the conclusion that the SEC's allegations were within the exclusion in the Warranty Letter."[14] In this regard, the court also discounted that the SEC's claims might be satisfied by mere negligence or reckless indifference rather than actual knowledge, because that was not what the SEC actually had

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Cell Phone Litigation Advisory: Calling For Coverage

by Jerold Oshinsky, Lorelie S. Masters, Samuel L. Feder and Cherylyn Briggs

The cell phone industry remains entangled in tort litigation to which its general liability insurance should apply. On October 29, 2009, the District of Columbia Court of Appeals held in *Murray v. Motorola, Inc.,* that plaintiffs' claims for bodily injuries resulting from cell phone use are not federally preempted if they arise from the use of cell phones that did not meet the radio frequency ("RF") radiation standards adopted by the Federal Communications Commission ("FCC"), or if the cell phones in question were manufactured before the FCC promulgated those standards in 1996. At the same time, tort claims for damages against cellular telephone businesses and industry associations are impliedly preempted insofar as they seek to hold defendants liable for bodily injuries from cell phones that did meet the FCC's RF radiation standards.[1] The ruling may lead plaintiffs to pursue new claims alleging injuries from cell phone usage from a variety of businesses involved in the cell phone industry. If such litigation ensues, cellular telephone businesses and industry associations should turn to their insurers to defend these suits and to pay for any resultant liabilities.

The preemption of state law in cases alleging cell phone injuries is an unsettled area of the law. In 2008, the U.S. District Court for the Eastern District of Pennsylvania[2] held that federal law preempted all state claims, but the U.S. Court of Appeals for the Fourth Circuit[3] came to the opposite conclusion.

The most important issue is whether insurers are required to defend the cellular telephone business or industry association in underlying cell phone injury class actions.

Murray held that plaintiffs can sue cellular telephone businesses and industry associations under the D.C. Consumer Protection Procedures Act by alleging that the businesses and industry associations misrepresented or omitted health information about potential safety issues. *Murray* also held that personal injury claims are not preempted in two situations: (i) if the plaintiffs' phones were built before 1996, the year the FCC began applying RF radiation limits to cell phones; or (ii) if the cell phones do not comply with FCC RF radiation standards.

Cell phone injury litigation raises a number of insurance coverage issues. The most important issue is whether insurers are required to defend the cellular telephone business or industry association in underlying cell phone injury class actions. Class actions alleging injuries from cell phone use have asserted that the cellular telephone businesses and industry associations should have equipped the phones with headsets to keep the phones (and emitted radiation) away from the user's head where the RF radiation allegedly causes biological harm at the molecular level. Plaintiffs have sought general damages including, but not limited to, amounts necessary to purchase headsets and compensatory damages flowing from plaintiffs' biological harm at the molecular level. In these kinds of cases, liability insurers often have refused to defend policyholders on the premise that the class actions did not sufficiently allege claims of "bodily injury" and "damages" due to "bodily injury" covered under the policies.

Commercial General Liability (CGL) insurance policies do not require a prescribed amount of "bodily injury" before

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Checklist for Renewing D&O Insurance Coverage

by Lorelie S. Masters

Directors & Officers (D&O) insurance policies, never standard, continue to evolve in light of the bank failures and corporate scandals in recent years. Below is a shorthand list of provisions to review carefully at your next renewal.

- ☐ Protecting Independent and "Innocent" Directors and Officers
  - ○ Ideally, D&O policies should not be rescindable, especially the "Side A" coverage.
  - ○ In addition to non-rescindability, or alternatively, guarantee severability of representations in the application, to protect and preserve coverage for innocent directors & officers.
- ☐ Trigger
  - ○ D&O policies are claims-made policies and, thus are triggered or activated by a "claim" made during the policy period.
  - ○ Some policies are "single-anchor policies," and require one event to take place during the policy period (usually, the claim against the policyholder).
  - ○ Some policies require two events during the policy period (claim against the policyholder *and* notice to the insurer). Such double-anchor policies could be more difficult to trigger.
  - ○ Attempt to buy D&O policies that include a single-anchor only.
- ☐ Alternative to Entity, or Side C, Coverage
  - ○ With the demise of entity coverage, consider including a preset allocation formula in your policy or program.
- ☐ Protection Against Insolvency of Policyholder Company
  - ○ Provide that deductibles or SIRs, which may be substantial, do not apply if the company is insolvent.
  - ○ Include priority of payments provisions, which help ensure that the individual insureds obtain maximum protection and are "paid first."
- ☐ Definition of "Insureds"
  - ○ Review the definition of "insured" to make sure it is broad enough to cover all of those for whom protection is sought.
- ☐ Definition of "Claim"
  - ○ Ensure that coverage is broad enough to pay for administrative, regulatory, civil, and criminal proceedings.
  - ○ Attempt to obtain coverage for both "formal" and "informal" investigations, if the policy makes a distinction.
  - ○ Cover not only litigation, but also alternative dispute resolution proceedings and investigations, which are increasingly common.
- ☐ Defense Cost Issues
  - ○ Review insurer's list of panel counsel and negotiate alternatives.
  - ○ Avoid provisions granting the insurance company the right to recover payment of, or recoupment of defense costs.
  - ○ Review "consent to settle" clauses.
  - ○ Ask to review insurer's billing guidelines *before* purchase; amend them if necessary to avoid disputes when claims arise.
- ☐ Ensure Coverage for All International Risks and Global Exposures
- ☐ Review All Exclusions, but Especially Consider, Modify, or Eliminate the Potential Impact of the Following Exclusions:
  - ○ Deliberate, Fraud, or Criminal Acts Exclusions. The most desirable form of these exclusions from a policyholder's perspective are those that require a final adjudication and finding of fraud or other "bad" conduct in a securities litigation.
  - ○ Prior Acts, Prior Notice, and Prior Pending Litigation Exclusions. Narrow them or, ideally, eliminate them. Buy back the prior litigation date to the earliest date possible. Ideally, purchase full "prior acts" coverage.
  - ○ Insured vs. Insured Exclusion. This should not apply to preclude coverage when the debtor in bankruptcy is involved for an insolvent policyholder or when the (former) insureds are adverse to each other.
- ☐ Severability of Exclusions
  - ○ Include severability provisions in conduct-related exclusions, but otherwise try to limit or avoid these exclusions.
  - ○ Refuse extracontractural exclusions inserted into "warranty letters."
- ☐ Application Provisions
  - ○ Limit the documents and representations in policy "warranty" provisions.
- ☐ Issues for Excess D&O Policies
  - ○ Confirm that they follow form in key respects to underlying policies.
  - ○ Eliminate "actual payment provisions" which provide that excess policies do *not* attach unless the underlying insurers, and only they, pay 100% of the underlying limits.

U.K. Court Protects U.S. Policyholders by Rejecting Solvent Scheme

by Brian S. Scarbrough

At the urging of U.S. policyholders, a Scottish court recently rejected a Scottish insurance company's efforts to close its books and avoid full liability for long-tail claims when the insurance company is solvent and entirely capable of paying claims.

Under U.K. law (§899 of the Companies Act of 2006), insurance companies that are solvent may, with the approval of a requisite number of creditors (i.e., policyholders), enter into a "solvent scheme of arrangement." Such a "scheme" enables the solvent insurance company to cut off its liability completely, including for incurred but not reported ("IBNR") claims, and close its books entirely. While an insolvent insurance company can also enter into such a scheme, comparable to a U.S.-style liquidation, the ability of solvent insurance companies to do so has no such parallel in the U.S. Thus, many U.S. policyholders with insurance written by U.K. insurance companies, such as the London Market, are surprised to learn that they can lose valuable and often irreplaceable insurance coverage for long-tail liabilities, despite their objection, from solvent U.K. insurers through such schemes. U.S. policyholders for many years have objected to such a practice with little success as solvent scheme after solvent scheme was sanctioned by U.K. courts. However, a recent decision by a Scottish court finally offers some of the additional protections U.S policyholders were seeking.

Many U.S. policyholders with insurance written by UK insurance companies, such as the London market, are surprised to learn that they can lose valuable and often irreplaceable insurance coverage for long tail liabilities...

With the decision, *In re Scottish Lion Insurance Company Limited*,[1] Lord Glennie of the Scotland Court of Session dealt a critical blow to the ability of the Scottish Lion Insurance Company Limited ("Scottish Lion"), a London Market company, to enter into a solvent scheme of arrangement. Scottish Lion, fully able to meet its financial liabilities, sought to close its books on long-tail claims through a solvent scheme of arrangement. The company received permission last year to convene a meeting at which time creditors would have the opportunity to vote on whether to enter such a scheme. The vote ostensibly passed the requirements of U.K. law with at least a majority in number representing 75% in value of the creditors present at the meeting voting for the scheme. Scottish Lion then moved for a Scottish court to sanction the scheme and set a date by which all claims, including all IBNR claims, had to be submitted. Several U.S. creditors opposed the sanction, challenging both the manner in which creditors' votes were valued and the ability of a solvent insurance company to force unwilling creditors into a scheme of arrangement through a majority vote.

The Scottish court ruled that the U.S. creditors were entitled, at that stage of proceedings, to challenge the valuation of the vote, including challenges that the vote was unfair and not representative, affected by special interests, and that the counting and valuation of the

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Practice Tip—Renewal of Excess Policies

Policyholders facing renewal of their insurance programs should work to assure the consistency of terms among the various layers of coverage. This is true in all insurance programs, including CGL, D&O, employment practices, property, and other insurance programs. While excess insurance policies may "follow form" to underlying policies, that is not sufficient to assure consistency of terms from one layer to the next. Excess policies typically include their own provisions and endorsements, many of which, in our experience, change coverage in significant ways from layer to layer, creating possible inconsistencies and "gaps" in coverage. If a dispute arises, coverage may not exist in all layers to the extent it exists in the primary policy.

In addition, if disputes arise as a result, the policyholder may face the need to pursue a variety of different coverage actions in order to vindicate coverage. Some policies may require arbitration in different forums, while others allow litigation. The policyholder, therefore, may face a variety of litigations and arbitrations to establish coverage throughout all layers of the insurance program. That process not only leads to excessive legal costs for coverage counsel, but may pose the additional risk of inconsistent results.

A review of policies before purchase can avoid or minimize such inconsistencies.

U.K. Court Protects U.S. Policyholders by Rejecting Solvent Scheme

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vote was flawed in methodology or contained other significant errors. The U.S. creditors challenged what they considered selective devaluation of votes by Scottish Lion, particularly of votes against the scheme. Lord Glennie also ruled that while there is not an explicit rule against sanctioning solvent schemes in the face of creditor dissent, justification is required to demonstrate why dissenting minority creditors should be bound by the decision of the majority. The court reasoned that, unlike insolvent schemes, where financial difficulties necessitate binding dissenting minority creditors to the will of the majority, solvent schemes lack such financial justification. The court stated that there might be reasons apart from financial uncertainty justifying a solvent scheme; however, such reasons must be made apparent when seeking to sanction the scheme. The court also stated "unreasonableness seems to me to stem from the fact that where the company is solvent it is unnecessary for the body of creditors or class of creditors to [agree] as a whole that there should be any scheme, still less a scheme forced upon unwilling participants."

In a separate order that followed this decision, the court entered a final judgment refusing to sanction the scheme. Scottish Lion stated plans to appeal the decision.

This ruling and the court's refusal to sanction the scheme are important victories for U.S. policyholders seeking to protect their insurance coverage, particularly occurrence-based, long-tail liability insurance coverage, which is a valuable and often irreplaceable corporate asset. The Scottish court has recognized the unfairness that U.S. policyholders for years have argued is present in the ability of a solvent insurance company to close its books against the objections of dissenting policyholders. Should this decision be upheld on appeal, it will serve as an important check on future solvent schemes of arrangement.

Endnote

1 Re *Scottish Lion Insurance Company Limited* [2009] CSOH 127, *available at* 2009 WL 284138.

How to Avoid the Impact of a Warranty Letter– a Cautionary Tale

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alleged.[15] Finally, in response to the insureds' point that Twin City had to show that they not only knew of facts related to acts that could give rise to a claim under the policy, but that "they *appreciated* that those facts could give rise to a claim under the policy," the court, making a small leap of observation, found that: "It is untenable for plaintiffs to suggest that the allegations in the SEC's amended complaint support a reasonable inference that each and every one of them could have failed to appreciate the potential for liability from the actions they are alleged to have taken prior to May 1, 2002."[16]

A Cautionary Tale

Rivelli presents a cautionary tale for any prospective policyholder confronted with a request to sign a warranty letter. Critically, in the district court, Twin City actually acknowledged that the SEC's claims *would* have triggered the coverage afforded by the top layer Twin City sold to Fischer *but for* the warranty letter.[17] This stands to reason, because most policies containing actual "prior knowledge" exclusions also contain severability provisions that limit the application of the exclusion to those insureds who actually possessed the knowledge, which in this case would have preserved Twin City's defense obligation as to any of the insureds who might not have had the requisite knowledge.[18] Thus, far from merely restating the policy's existing terms, the warranty letter in *Rivelli* provided the insurer with yet another basis upon which to avoid its defense cost coverage obligations.

In light of cases like *Rivelli*, a policyholder should, whenever possible, decline to sign a warranty letter. The insurer will already be protected to the extent necessary by the existing exclusions in the policy and through the policyholder's provision of accurate information in the application. Except in the case of new market entrants, who may seek extra protection while they build up reserves, the only real reason for an insurer to request a warranty letter is to provide the insurer with yet an additional basis to limit otherwise favorable terms and conditions in the policy.

The holding in *Rivelli II* remains atypical, and should not be interpreted to create a new right for insurers to avoid their defense obligations based on the exclusionary effect of a warranty letter. Properly interpreted, Twin City's warranty letter was activated only by definite knowledge of wrongful conduct giving rise to a claim of *such severity* that it could exceed the limits of the primary D&O coverage *and* the first layer of excess coverage. The conclusions of the district court and the court of appeals that at least one of the *Rivelli* plaintiffs had such knowledge remain questionable, as very few insureds, even experienced business people, can actually predict the scope of potential litigation before it begins. In any event, the vast majority of securities-related complaints are not, in fact, written so narrowly that they prevent any likelihood of a potentially covered claim, and thus an insurer's broad defense obligation typically should apply.

Endnotes

1 *Rivelli v. Twin City Fire Ins. Co.*, —F. App'x—, 2009 U.S. App. LEXIS 23559 (10th Cir. Oct. 26, 2009) (*Rivelli II*).
2 *Id.* at *3.
3 *Id.*
4 *Id.*
5 *Id.* at *4.
6 *Id.* at *4-*5.
7 *Id.* at *5.
8 *Id.* at *6.
9 *Id.*
10 *See Rivelli v. Twin City Fire Ins. Co.*, No. 08-cv-01225-RPM, 2008 U.S. Dist. LEXIS 99678 (D. Colo. Nov. 21, 2008) (*Rivelli I*).
11 *Rivelli II*, 2009 U.S. App. LEXIS 23559 at *6 (quoting *Rivelli I*, 2008 U.S. Dist. LEXIS 99678 at *8) (internal quotations and brackets omitted).
12 *Id.* at *9.
13 *Id.* at *12.
14 *Id.* at *14-*15 (internal quotations omitted).
15 *Id.* at *16-*17.
16 *Id.* at *16.
17 *Rivelli I*, 2008 U.S. Dist. LEXIS 99678 at*12.
18 *See Nicholls v. Zurich Am. Ins. Group*, 244 F. Supp. 2d 1144, 1156-57 (D. Colo. 2003) (insurer not excused from D&O defense obligation unless "there is no factual or legal basis on which the insurer might eventually be held liable to indemnify the insured") (internal quotations omitted).

Cell Phone Litigation Advisory: Calling for Coverage

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coverage will apply. Indeed, courts have specifically upheld coverage even when the alleged injury took place at a molecular level. Courts also have refused to bar coverage for preventive measures. Instead, courts have upheld the insurers' duty to defend underlying actions that allege subclinical harm from cellular telephone radiation, and required them to pay the policyholder's liability to compensate class members for headsets (or the costs of headsets). For example, a Texas appellate court rejected the insurers' arguments against coverage on the ground that claimants suffered no "diagnosable disease." The court found no requirement that the injury be currently capable of diagnosis in the definition of bodily injury.[4] Indeed, allegations of "adverse cellular change" have qualified as assertions of "bodily injury" under CGL policies in a number of decisions.[5] These decisions have found allegations of molecular injury as the precursor of cancer to be sufficient to bring allegations within the definition of "bodily injury" in the policies. As the *Samsung* court held, the insurers' "lack of harm" argument would, in effect, read an additional exclusion into the policy.[6]

Insurance companies also argue that the cell phone cases do not seek covered "damages" under CGL insurance policies to the extent plaintiffs seek only headsets or similar relief. Courts have generally rejected this argument. For example, in *Motorola Inc. v. Associated Indemnity Corp.,*[7] the class sought "economic restitution" for headsets for plaintiff's cell phones, as well as costs of medical monitoring and other "claims for any individualized physical injury." The *Motorola* court concluded that the relief sought constituted covered damages. Similarly, in *Voicestream Wireless Corp. v. Federal Insurance Co*., the court also upheld coverage, finding that the headsets protected users from injury due to exposure to radiation and thus constituted covered damages.[8]

Murray adds to the debate over whether federal regulations should trump state laws in cases of alleged cellular telephone injuries. The plaintiffs there allege they suffered illnesses, including brain cancer, due to radiation emitted from their cell phones, and that the cellular telephone businesses' and industry associations' marketing misled them into believing their products were safe. The plaintiffs also claim that their phones failed to meet FCC regulations limiting the amount of radiation released. Although the decision seemingly raises the bar for plaintiffs, it also provides additional routes for parties seeking damages from cellular telephone businesses and industry associations. Cellular telephone businesses and industry associations and others implicated in these suits should look to their CGL insurers for protection.

Endnotes

1 *Murray v. Motorola, Inc.,* No. 07-cv-1074, ____A.2d____, 2009 WL 3459991 (D.C. Oct. 29, 2009)

2 *Farina v. Nokia, Inc.,* 578 F. Supp. 2d 740 (E.D. Pa. 2008)

3 *Pinney v. Nokia, Inc.,* 402 F.3d 430 (4th Cir. 2005).

4 *Samsung Elecs. Am., Inc. v. Federal Ins. Co.,* 202 S.W.3d 372, 382 (Tex. App. Dallas 2006) *aff'd*, 268 S.W.3d 506 (Tex. 2008).

5 *Zurich Am. Ins. Co. v. Nokia, Inc.,* 268 S.W.3d 487, 492 (Tex. 2008); *Northern Ins. Co. v. Baltimore Bus. Commuc'ns, Inc.,* 68 F. App'x 414, 419 (4th Cir. 2003).

6 *See Samsung Elecs.,* 202 S.W.3d at 378.

7 *Motorola, Inc. v. Associated Indem. Corp.,* 878 So. 2d 824, 834 (La. Ct. App. 2004).

8 *Voicestream Wireless Corp. v. Federal Ins. Co.,* 112 F. App'x 553, 556-57 (9th Cir. 2004).

Chinese Drywall: The "Silent Hurricane" or a Manageable Product Exposure? Insurance Coverage Considerations

by Matthew L. Jacobs

A great deal has been written about Chinese, or imported, drywall, which was imported into the country and used in up to 100,000 homes between 2005 and 2007. The drywall was imported because of the shortages of building materials resulting from Hurricane Katrina re-building efforts going on at that time. There is a substantial debate right now over whether all of the imported drywall was installed in homes throughout the country, or whether much of it remains in warehouses. Some sources have estimated that it could have been installed in up to 100,000 homes, based only upon the number of board-feet imported and the average size of a new home being built at that time. Others estimate that only 16,000 homes contain imported drywall, a much smaller and more manageable exposure.

There are approximately 215 federal cases brought by homeowners as of November 1, 2009, alleging both property damage and bodily injury from exposure to Chinese drywall. As of that date, there were 197 state lawsuits involving Chinese drywall, the vast majority having been filed in Florida. The majority of the federal cases have been transferred, for pre-trial purposes, to the MDL court in New Orleans, in the Eastern District of Louisiana, presided over by Judge Eldon Fallon, where the proceeding is known as MDL 2047. Judge Fallon has taken charge of these cases, and has issued numerous pre-trial orders concerning the preservation of evidence, discovery protocols, and the submission of plaintiff profiles. He ordered that the plaintiffs serve a consolidated Master Complaint by December 9, 2009. Pre-trial Order Number 17 requires that the Master Complaint be served by that time because Knauf Tianjin has agreed to accept service of the Complaint, while preserving its ability to assert jurisdictional challenges.

Whether the Chinese drywall problem will be a "silent hurricane," as some plaintiffs have dubbed it, or whether it will reflect a manageable exposure for the manufacturers, importers, distributors, subcontractors and home builders that were involved in the chain of home installation, insurance coverage will be one of the primary issues that a number of courts consider as allegedly responsible parties turn to their insurers to respond to these classic bodily injury and property damage claims, arising from an accident that no one could possibly have foreseen.

Currently, there are no reported cases on the availability of insurance coverage to respond to these claims – which also include claims for "personal injury" as defined in CGL policies. Several cases have been filed by insurers against policyholders seeking a declaration of no coverage for Chinese drywall claims. *See, e.g., Builders Mut. Ins. Co. v. Dragas Mgt. Corp., et al.*, C.A. No. 2:09cv185 (E.D. Va. 2009); *General Fidelity Ins. Co. v. Foster, et al.*, Case No. 09-80743 (S.D. Fla. 2009). None of these cases has resulted in any rulings on whether coverage is available – either for defense costs or indemnity. Among the issues that will determine the availability of coverage, the following seem to be the most likely to become the subject of motions practice in the near future, at least as reflected in reservation of rights letters sent to policyholders: (1) the "absolute" or "total" pollution exclusion, (2) the number of occurrences, (3) the "your work" exclusion, (4) the "your product" exclusion, (5) the "impaired

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Chinese Drywall: The "Silent Hurricane" or a Manageable Product Exposure? Insurance Coverage Considerations

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property" exclusion, (6) the existence of an "accident," and "occurrence," as defined by the policies, and (7) the trigger of coverage. Insurers also may argue that remediating Chinese drywall homeowner claims before a suit is filed constitutes a "voluntary payment" or a payment made in the absence of a "legal obligation," initiating coverage.

Despite the many exclusions and limitations insurers have asserted as a basis to avoid their coverage obligations (as to which they bear the burden of proof), insurers have overlooked that the underlying damage has arisen from a classic accident (or "occurrence"), and that most courts addressing these issues have found that the consequential property damage resulting from a defective product constitutes a covered "occurrence" sufficient to trigger the products/completed operations coverage in a general liability or umbrella policy. *See Stanley Martin Cos. v. Ohio Cas. Group*, 2009 WL 367589 (4th Cir. Feb. 12, 2009). Moreover, many courts addressing the possible applicability of the so-called absolute or total pollution exclusion have held that these exclusions were never intended to, and should not, bar coverage for losses arising from non-industrial sources of pollution. *See, e.g., Pipefitters Welfare Educ. Fund v. Westchester Fire Ins. Co.*, 976 F.2d 1037, 1043 (7th Cir. 1992) ("Without some limiting principle, the pollution exclusion clause would extend far beyond its intended scope, and lead to some absurd results"); *Donaldson v. Urban Land Interests, Inc.*, 564 N.W.2d 728, 732 (Wis. 1997); *Sullins v. Allstate Ins. Co.*, 667 A.2d 617, 624 (Md. 1995). Granted, there are decisions contrary to these holdings, holding, for example, that bodily injury resulting from exposure to toxic floor sealant, after its application, is not covered due to the absolute pollution exclusion. Even those decisions, however, would not apply to bar coverage for property damage resulting from Chinese drywall, which is not toxic, is a common building product and was never considered to be harmful – in any form – before the recent homeowner reports of property damage and minor bodily injury (watery eyes, running noses and throat irritation). Insurers will have a hard time demonstrating that various forms of the pollution exclusion, adopted to address environmental, industrial pollution events, should be applied to bar coverage for damage resulting from the use of a common building product.

The battle lines now have been drawn in many federal and state courts, as well as the MDL. Insurers and policyholders will soon be engaged in discovery, motion practice, and trials over these pressing and undetermined issues.

Calendar of Speaking Engagements

March 5-7, 2010

American Bar Association Section of Litigation

Insurance Coverage Litigation Committee CLE Seminar

Westin La Paloma, Tucson AZ

http://www.abanet.org/litigation/committees/insurance/calendar_annual.html

Kali N. Bracey – "Rescission Is the New DJ"

David M. Greenwald – "Resolving Reinsurance Disputes at Home and Abroad"

Matthew L. Jacobs – "Resolving Complex D&O Claims Through Multiple Layers of Coverage"

Jerold Oshinsky – "Expanding Insurance Coverage Issues Related to Computer and Internet-Based Technologies"

March 24-25, 2010

American Conference Institute's National Advanced Forum

Professional Liability Insurance: Master Class on Crafting E&O/Professional Liability Coverage and Conducting Renewals

Carlton on Madison Avenue, New York, NY

http://www.americanconference.com/ProfLiab.htm

David M. Greenwald – Co-Chair

Matthew L. Jacobs – Speaker: "Defending Against Common Policy Exclusions and Knowing When the Exclusion Will be Triggered"

April 8-10, 2010

American Bar Association Section of Dispute Resolution

Section of Dispute Resolution Spring Conference

Hyatt Regency, San Francisco, CA

https://www.abanet.org/aba_timssnet/meetings/tnt_meetings.cfm?action=long&primary_id=DR1004&webtextid=47913&Subsystem=MTG&related_prod_flag=0

Kali N. Bracey – "Will Insurance Be in Place When You Need to Settle? Top Ten Traps for Careful ADR Preparation"

June 7, 2010

Practising Law Institute

Corporate and Professional Liability Insurance Law 2010

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Jenner & Block Welcomes the "Dean of the Insurance Policyholder Bar" — Jerold Oshinsky

Jerold Oshinsky, considered one of the leading policyholder side insurance coverage litigators in the nation, has joined Jenner & Block's Los Angeles office. His addition bolsters the Firm's already strong national insurance coverage litigation practice, creating a powerhouse for clients having disputes with insurers about coverage.

Chambers recognizes Mr. Oshinsky as the "dean of the policyholder bar," and in 2009 again included him in its top-tier "Band 1" national ranking based on feedback from corporate clients and peers. He was recognized by *Legal Times of Washington* in 2007 as one of the ten best insurance attorneys who have practiced in Washington, DC in its *"Leading Lawyers"* honors, and the newspaper also selected Mr. Oshinsky as "The Leading Lawyer in Insurance" for Washington, DC, in October 2007. He is regularly cited in *Best Lawyers*, *Super Lawyers* and in the *Lawdragon 500 Leading Lawyers in America*, among others.

Mr. Oshinsky's rise in the insurance coverage arena started with his representation of Keene Corporation in the landmark insurance coverage case, *Keene Corp. v. Insurance Co. of North America*. In this seminal case, the U.S. Court of Appeals for the District of Columbia Circuit in 1981 established the "continuous trigger" and "all sums" principles that have been applied in insurance coverage throughout the United States. Since that litigation, he has litigated, and is now litigating, many of the most significant and cutting-edge insurance coverage issues in the country. His expertise has touched numerous Fortune 500 companies, including AT&T, Emerson Electric, General Motors, Hercules, Louisiana-Pacific, Merck, Monsanto, Pfizer, and North American Philips, to name a few.

Jerold Oshinsky

Mr. Oshinsky is a principal author and editor of *Practitioner's Guide to Litigating Insurance Coverage Actions* (Aspen Law & Business), and publishes and lectures extensively on insurance coverage issues across the nation.

Insurance Counselor is published regularly by Jenner & Block and appears on the Firm's website at www.jenner.com/news/pubs.asp.
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