FDCC REINSURANCE, EXCESS AND SURPLUS LINES SECTION
JULY 2011 PRE-ANNUAL MEETING UPDATE

Annual Meeting in Williamsburg, Virginia
For details and to make hotel reservations click on the following link:
http://www.thefederation.org/process.cfm?PageID=4&TopLevel=6&calendarDate=2011_07&Day=24&EventID=128

Our Substantive Law Section Meeting is Thursday, July 28, 2011 at 7:30 a.m. - 8:45 a.m.

We are co-sponsoring with Insurance Coverage, Appellate Law and Extra-Contractual Sections.

Topic:
Splitting Files: Liability, Coverage and Ethical Implications

Insurers, insurance defense counsel and coverage counsel are constantly faced with the dilemma of when and how to split a file, between liability and coverage, and what information and knowledge can be shared between the respective attorneys and claim handlers. Failing to split a file, when appropriate, or failing to correctly handle a split file, can impact both the liability and coverage issues, and can raise ethical and bad faith issues, while impacting an insurer's settlement posture. There is little case law on these issues. This program will discuss these issues and suggest when and how to split files so as to avoid the minefields associated with this complex issue. Discussions will include the information that can be shared between file handlers, how to handle settlement negotiations, as well as bad faith exposure. In addition, the panel will address the ethical issues for defense and coverage counsel and provide real world examples.

Moderator: John G. Farnan, Weston Hurd, LLP, Cleveland, OH

Panelists:

- Paul Garrison, Infinity Insurance Companies, Birmingham, AL
- Laura (Megan) Faust, Roetzel & Andress, LPA, Akron, OH
- Kate Browne, Swiss Reinsurance America Corporation, New York , NY
- Edward J. (Ned) Currie, Jr., Currie, Johnson, Griffin, Gaines & Myers, P.A. - Jackson, MS
- April A. Elkovitch, Senior Litigation Counsel, Meadowbrook Insurance Group, Westerville, OH

WILLIAMSBURG SECTION BUSINESS MEETING AGENDA

Immediately after Joint Section Presentation at 8:45 a.m. to 9:00 a.m.

- Brief overview of the Section's proposed joint presentation for the 2012 Winter Meeting in Phoenix.
- Discussion regarding potential topics for 2012 Annual Meeting at the Fairmont Chateau in Whistler, BC.
- Solicit information for the newsletter and website.
- Ideas regarding the Section's two candidates for admission to the FDCC.
- Volunteers to cover the hot case project.
- Thoughts for future submissions to the FDCC quarterly would be great.
- Any other business.

Other Upcoming FDCC Events

FDCC Leadership Institute
Colonial Williamsburg, Virginia - July 25 through July 27, 2011

Corporate Counsel Symposium
Four Seasons Hotel, Philadelphia Pennsylvania - September 20 through 22, 2011

Insurance Industry Institute
New York Athletic Club, New York, New York - November 16 through 18, 2011

This year's Insurance Industry Institute, entitled "Addressing Industry-Wide Challenges in Unsettled Times," will focus on four areas that senior level insurance executives and their counsel will confront in coming years: (a) the changing regulatory landscape; (b) challenges to the protection of privileged information; (c) privacy protection and legal exposures; and (d) the blurring of international borders in insurance claims arising out of claim exposures and natural disasters that cross boundaries.

The Insurance Industry Institute brochure and registration is available on the website now. Section members Andy Downs, Mike Aylward, and Kate Browne will be spreading the word about this year's Institute during the Section's claims splitting program on Tuesday morning so come by for more information. The room block at the New York

Athletic Club is limited to sign up early (and remember, defense counsel members need to bring an industry guest).

2012 Winter Meeting at Waldorf Astoria Arizona Biltmore in Phoenix

We are co-sponsoring a meeting with the Insurance Coverage, Appellate Law, and the Extra Contractual Sections. One topic that has been proposed addresses the obligations and bad faith pitfalls insurers face when responding to multiple claims exceeding policy limits. We are still in the planning process and soliciting speakers, so if you would like to be involved and give us your input, now is the time. We also welcome any suggestions regarding industry speakers based on your own experience in this area and contacts with insurers in the Arizona region.

Miscellaneous

If any of you are interested in reporting new reinsurance cases or any other insurance topic that is relevant to our Section, please let me know. The hot cases are listed on the FDCC website daily, but many times there are no Reinsurance-related cases or issues. I would like to receive information from you to include in an email to Section members to keep everyone apprised of cases that affect us and our practices.

Case Law

Mike Aylward has provided us with the following new case information:

After a difficult 2010 campaign, 2011 has so far been a favorable year for excess insurers batting efforts to prematurely involve them in the defense or indemnification of large losses. In particular, several recent cases have developed two notable themes addressing (1) whether excess insurance may be triggered where the insured settles with lower layers for less than full limits and (2) whether an umbrella insurer's duty to defend is triggered by the exhaustion of the specific primary policy listed in its schedule of underlying insurance where primary insurers in other years are continuing to defend. Additionally, a newly-filed appeal in the Rhode Island Supreme Court calls into question whether "solvency schemes" have a future in the U.S.

1. The Qualcomm Conundrum

It is not uncommonly the case that an insured settles large law suits against a tower of coverages for GL or D&O exposures for less than the full limits of each policy. In such circumstances, is its failure to fully exhaust the underlying limits a basis for the higher layer excess to dispute their duties.

In the past, insureds had argued with considerable success that it was sufficient that their liabilities exceed the retention amounts and that excess insurers in such cases were no worse off by reason of the insured having absorbed a portion of the loss in order to settle than if the underlying insurer paid the entire limit itself. However, excess carriers' fortunes improved dramatically following Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London, 73 Cal. Rptr.3d 770 (Cal. App. 2008), a case in which the California Court of Appeal held that the excess carrier's requirement "had been liable to pay the full amount of the underlying limit of liability" was not susceptible of contrary meanings and could only reasonably be understood as only requiring coverage where a court order or judgment had entered declaring the insured's liability to pay more than the underlying limits.

In the years since Qualcomm, courts have see-sawed on this issue, with some holding to the older view exemplified by Zeig v. Massachusetts Bonding & Ins. Co., 23 F.2d 665 (2nd Cir. 1928) that the public policy in favor of settlement would be thwarted by enforcing such language and other courts giving effect to such language where it is clear and unambiguous. Compare Trinity Homes LLC v. Ohio Cas. Ins. Co. 2010 WL 5174697 (7th Cir. December 22, 2010)(Indiana law)(refusing to enforce) with Great American Ins. Co. v Bally Total Fitness Holding Corp., 2010 WL 2542191 (N.D. Ill 2010) and Comerica Inc. v Zurich Am. Ins. Co., 498 F Supp. 2d 1019, 1034 (E.D. Mich. 2007)(giving strict effect to exhaustion requirement).

In the latest such case, the Appellate Division of the New York Supreme Court adopted the Qualcomm view, holding in J.P. Morgan Chase v. Indian Harbor Ins. Co., 603766/08 (App. Div. May 26, 2011) that a securities class action settlement that an investment bank entered into with Zurich for less than the underlying limits precluded the insured's right to recovery under a higher layer policy issued by Twin City which stipulated that, "It is expressly agreed that liability for any loss shall attach to the underwriters only after the Primary and Underlying Excess Insurers shall have duly admitted liability and shall have paid the full amount of their respective liability. . . ." The Appellate Division distinguished Zeig as involving entirely different language that lacked the specificity of the Twin City policy. The Appellate Division declined to set aside this unambiguous language in light of the claimed reasonable expectations of the insured as reflected in the testimony of an alleged expert witness concerning the custom and practice of excess insurers. The Court declared that, "While this Court certainly favors and encourages settlements of cases whenever possible, it cannot do so in contravention of the clear language of the policy."

In contrast to this New York holding (applying Illinois law), the Missouri Supreme Court has ruled that an excess insurer's obligation to pay a $4.5 million judgment against its insured was not relieved by reason of the fact that the primary insurer had settled its share of the claim by paying less than its full $1 million policy limit. In Schmitz v. Great American Assur. Co., No. SC91098 (Mo. April 26, 2011), the Supreme Court ruled that nothing in the primary policy required the insurer to actually pay its limits and that the excess insurer should therefore be liable for the excess amount of the judgment exceeding $1 million.

2. The Underlying Insurance Conundrum

A related issue is whether an excess insurer's obligations are triggered by the exhaustion of the policy issued below it that is described in the Schedule of Underlying Insurance or whether, in long-tail claims or other cases where multiple primary policies are triggered, the entire underlying layer must be exhausted before the excess insurer has a duty to pay.

The key in these cases has proved to be the exhaustion language in the excess policies and, in particular, whether it refers solely to the policies identified in the Schedule of Underlying Insurance. Where excess policies specifically reference other underlying insurance, courts have not hesitated to make its exhaustion a pre-condition of excess coverage.

The U.S. Court of Appeals for the Sixth Circuit recently ruled in Federal-Mogul U.S. Asbestos Personal Injury Trust v. Continental Cas. Co., No. 10-1290 (6th Cir. July 8, 2011) that an umbrella carrier had no obligation to provide a defense to underlying asbestos claims following the exhaustion of the specific CGL policy listed in its schedule of underlying insurance where other primary insurers were still defending in light of language in the policy indicating that the insurer's obligation to defend only arose "when an occurrence is not covered by the underlying insurance listed in the underlying insurance schedule or any other underlying insurance collectible by the insured, but covered by the terms of this policy. . . ." Further, the Court refused to find that Continental's defense obligation was triggered by Condition 3 to the umbrella policy which required the umbrella carrier to "continue as underlying insurance" following the exhaustion of all underlying policies. While acknowledging that the reference to "underlying policies" might be found to be ambiguous if taken out of context, the Court held that in this case the policy was clearly referencing prior language in Condition 3 that referred to Continental's liability as being for the ultimate net loss in excess of "the underlying limits of liability of the underlying insurance policies as stated and described in the Declarations and those of any underlying insurance collectible by the insured." The Sixth Circuit held, therefore, that under Michigan law the umbrella carrier's obligation to defend did not arise until such time as all primary insurance had become exhausted. Further, the Court rejected the Trust's argument that it should be entitled to discovery on the parties' intent with respect to such concerns, holding that Michigan does not allow extrinsic evidence to determine intent when the words in question are clear and unambiguous and have a definite meaning.

The Sixth Circuit's analysis tracked the 2009 opinion of the Seventh Circuit in an Indiana case. In Castronovo v. National Union Fire Ins. Co., 571 F.3d 667 (7th Cir. 2009), the Seventh Circuit ruled that where an umbrella policy only listed a primary policy issued by Travelers in its schedule of underlying insurance but the insured maintained a separate primary policy through Owners. Both policies were required to be exhausted since Owners was providing a defense to the insured and the National Union umbrella policy stated that, "We shall have the right and duty to defend any claim or suit when damages sought are covered by this policy but not covered by any underlying insurance listed in the schedule of underlying insurance or any other underlying insurance providing coverage to the insured." Id. at 671.

3. Emerging Issues: Solvency Schemes?

While these issues of exhaustion are familiar to us all, a more novel issue is the subject of a recently-filed appeal in the Rhode Island Supreme Court. In In Re GTE Reinsurance, CA PB No. 10-3777 (R.I. Super. April 25, 2011), a state trial court had rejected a constitutional challenge brought by Hudson and Clearwater Insurance Companies ("Odyssey") to a reinsurer's commutation plan under Rhode Island's Voluntary Restructuring of Solvent Insurers Act. Judge Silverstein ruled that the Act, which allows insurers or reinsurers in run-off to propose a plan to extinguish their liabilities and terminate their business, did not effect an unconstitutionally substantial impairment of the cedents' contractual rights. The court declared that "simply stating that the Commutation Plan may provide for a different payout than originally contracted for is simply insufficient to rise to the level of substantial impairment." In any event, the Superior Court ruled that the Act was justified by a "significant and legitimate public purpose."

On April 27, 2011, Judge Silverstein entered an Implementation Order for the Commutation Plan. On May 2, 2011, the Objecting Creditors filed a notice of appeal from the Implementation Order.

Although solvency schemes are a common feature of reinsurance run-off in the United Kingdom and Bermuda, they have rarely been implemented in the U.S., if only because insurers cannot seek reorganization under the U.S. Bankruptcy Code. However, such schemes may be implemented in Rhode Island, which is the only state that has, to date, approved legislation allowing for reorganization of locally domiciled companies. As more and more states seek to adopt statutory and regulatory schemes to attract more insurers, captives and reinsurers, it will be interesting to watch the fate of this appeal and whether the Rhode Island Supreme Court will sustain Judge Silverstein's analysis.

Section Chairs

If you have any questions about the Section or the FDCC, please feel free to contact me or one of your Vice Chairs:

- Chair Meloney Perry, Meckler Bulger Tilson Marick & Pearson LLP Dallas TX

- Vice Chair Russell Allison, Carr Allison Birmingham AL
- Vice Chair Michael Aylward, Morrison Mahoney & Miller, LLP Boston MA
- Vice Chair Charles Henderson, Henderson Consulting and Risk Management Newtown Square PA
- Vice Chair Milton Thurm, McIntosh,Sawran, Peltz & Cartaya,P.A. West Palm Beach FL

For our detailed contact information and a list of all of our Section Members click on this link, which is on the FDCC website:
http://www.thefederation.org/process.cfm?pageID=6&groupID=256

Have a great day.

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