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MESSAGE FROM THE CHAIR

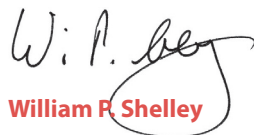
To the friends of Cozen O'Connor:

What follows is our latest edition of the firm's Insurance Coverage Observer, Winter 2010 edition – a winter that many of us on the East Coast are glad to see depart! In this edition, we cover key developments in coverage litigation in general liability, property, and bad faith, and in the process try to bring together some of the more important cases decided in the recent past.

We hope our Insurance Coverage Observer brings together for you these key cases over the last few months in a way that is easy to digest, and which complements our more "hot off the presses" alerts on individual cases.

In the upcoming editions, we will highlight many of our individual offices in an effort to help you get to know the attorneys in offices that you may not have personally dealt with over the years. We are certain that this information will give you a better sense of our depth of experience in our many offices around the country. Until then...

Best Regards,



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KEY DEVELOPMENTS IN COVERAGE LITIGATION 2009: GENERAL LIABILITY

Megan K. Kirk, Laura L. Edwards, and Daniel V. Ward (Seattle)

WISCONSIN RULES THAT EACH CLAIMANT'S EXPOSURE TO A TOXIC TORT IS A SEPARATE OCCURRENCE; ADOPTS "ALL SUMS" AND REJECTS PRO RATA ALLOCATION

Plastics Engineering Co. v. Liberty Mutual Ins. Co., No. 2008AP333-CQ, 2009 WI 13 (Wis. Jan. 29, 2009)

In *Plastics Engineering Co.*, the Wisconsin Supreme Court held that, under the "cause" test, each underlying claimant's repeated exposure to asbestos-containing products constitutes a separate "occurrence" where such exposures were separate in time, space and circumstance. The court also ruled that a Wisconsin statute prohibiting competing "other insurance" clauses from reducing the total indemnification available under the policies applied only to concurrent insurance policies, not to successive policies, and therefore the statute did not prevent enforcement of non-cumulation of limits provisions. Finally, in addressing the insurer's contentions regarding allocation among policies issued from the 1960s through 1989, the court expressly rejected a *pro rata* allocation and held the insurer must fully defend and pay all sums up to policy limits.

EXPOSURE TO MERCURY IS NOT ENVIRONMENTAL POLLUTION

Baughman v. United States Liability Ins. Co., 08-2901, 2009 U.S. Dist. Lexis 106400 (D.N.J. Nov. 12, 2009)

In *Baughman*, the District Court of New Jersey considered the question of whether mercury qualified as traditional or non-traditional environmental pollution. The case involved closure of a day care due to mercury contamination, allegedly caused because a thermometer manufacturing company operated in the building twenty years earlier. The court found that such contamination did not constitute "traditional environmental pollution" because such pollution "does not include exposure to toxic materials released indoors..."; thereby adopting an indoor-outdoor distinction.

DEBATE CONTINUES OVER COVERAGE FOR FAX-BLASTING CLAIMS

Auto-Owners Ins. Co. v. Websolv Computing, Inc., No. 07-3286, 2009 WL 2750263 (7th Cir. (Ill.) Sept. 1, 2009); *Alea London Ltd. v. American Home Services Inc.*, No. 1:09-CV-158 (N.D. Ga. Dec. 1, 2009); *New Century Mortg. Corp. v. Great Northern Ins. Co.*, 2009 U.S. Dist. LEXIS 100033 (D. Del. Oct. 26, 2009)

Three federal courts considered CGL coverage for liability for unsolicited facsimile transmissions in violation of the Telephone Consumer Protection Act, 47 U.S.C. § 227. In *Auto-Owners Ins. Co. v. Websolv Computing, Inc.*, the Seventh Circuit, applying Iowa law, held that there was no coverage for such claims, because the term "publication" as found in the policy narrowed the scope of privacy rights to secrecy rights and not seclusion rights. In *Alea London Ltd. v. American Home Services Inc.* and *New Century Mortg. Corp. v. Great Northern Ins. Co.*, the Northern District of Georgia and the District of Delaware, applying Illinois law, held that such claims were covered. These courts reasoned that the right of privacy was extended to the right of seclusion as well as secrecy.

DELAWARE COURT APPLIES ALL SUMS ALLOCATION METHOD IN ASBESTOS COVERAGE ACTION

Viking Pump, Inc. v. Century Indem. Co., C.A. No. 1465 (VCS) (Del. Ch. October 14, 2009)

In *Viking Pump*, a Delaware Court of Chancery, applying New York law, applied the "all sums" method of allocation in an asbestos bodily injury case. The court found that the *pro rata* allocation method was in contravention of the plain language of the policies, and that "[c]ourts more concerned with guaranteeing full compensation to tort plaintiffs and holding insurers accountable up to the full policy limits when a policy is triggered, tend to favor the all sums method." This decision is significant because it rejects the *pro rata* approach and allows the insureds to designate a single policy year to bear responsibility for a covered loss, leaving it up to those insurers to seek reimbursement from other insurers.

DUTY TO DEFEND TRIGGERED BY DISPUTE OVER WHICH POLICY FORMS CONSTITUTE THE FULL POLICY

Whittaker Corp. v. American Nuclear Insurers, No. 07-10515-RGA, 2009 WL 4342512 (D. Mass. Sept. 15, 2009)

In *American Nuclear Insurers*, the United States District Court for the District of Massachusetts held that an insurer's duty to defend may be triggered when there is a dispute between the insurer and the insured regarding which policy forms and endorsements constitute the complete insurance policy at issue. The court concluded that whether or not the policy contained an exclusion rendered it "at least plausible" that the policy did not exclude coverage. Further, the court reasoned that the possibility that the policy was issued without an exclusion was all that was necessary to trigger the duty to defend. This case is significant because it modified the well-established "potential for coverage" duty to defend standard applied by most courts.

INDIANA COURT APPLIES MONTROSE ENDORSEMENT TO FIND NO COVERAGE

Quanta Indemnity Co. v. Davis Homes, LLC, 2009 U.S. Dist. LEXIS 25392 (S.D. Ind. 2009)

In *Davis Homes*, the United States District Court for the Southern District of Indiana held that a "bodily injury" that took place prior to the CGL policy period, and was known to the insured prior to the policy period, was excluded from coverage. The personal injury at issue in *Davis Homes* was an apparent suicide that was determined by the court to be proximately caused by a previous electrical injury that occurred prior to the policy period. The court in this case enforced the insurer's Montrose Endorsement by examining the complaint and determining that the allegations directly connected the suicide to an electrical shock and resulting injuries that were sustained before the policy period. Further, the court found that the insured was aware of the injuries prior to the policy period.

NINTH CIRCUIT FINDS ANTI-ASSIGNMENT CLAUSE AMBIGUOUS

Alexander Mfg., Inc. Employee Stock Ownership Plan and Trust v. Illinois Union Ins. Co., 560 F.3d 984 (9th Cir. 2009)

In *Alexander Mfg.*, the Ninth Circuit Court of Appeals held that an anti-assignment clause prohibiting assignment of

"interest under this Policy" was ambiguous. Ultimately, the court allowed an assignee of an insurance policy to pursue claims for a breach of contract and bad faith against the insurer. The court based its decision on the ambiguity of the term "interest." Specifically, the court held that "interest" could plausibly refer to a purely financial stake in the policy or to causes of action arising under the policy.

COVERAGE IS PRO-RATED WHERE POLICY PERIODS OVERLAP

Boston Gas Co. v. Century Indemnity Co., 454 Mass. 337, 910 N.E.2d 290 (July 24, 2009)

In *Boston Gas Co.*, the Massachusetts Supreme Judicial Court held that the liability of each insurer under standard CGL policies should be prorated rather than joint and several. The prorated rule will apply where an insured has covered costs as a result of ongoing environmental contamination occurring over more than one year, and the insurer provided coverage for less than the full period of years in which the contamination occurred. The court found that the method of allocation must be "time-on-the-risk", unless there is actual evidence relevant to the distribution of property damage.

NO OBLIGATION TO PAY ATTORNEY FEE AWARD

State Farm General Ins. Co. v. Mintarsih, 175 Cal. App. 4th 274 (Cal. App. 2d Dist. 2009)

In *Mintarsih*, the Court of Appeal of California, Second Appellate District, Division Three affirmed a trial court holding that an insurer had no obligation to pay an attorney fee award. A domestic servant sued the insured for false imprisonment and employment-related claims and was awarded over \$700,000 in attorney fees for wage and hour claims. The insurer filed a complaint for declaratory relief, arguing that the attorney fee award was based on claims for which there was no coverage under the policies. The Court of Appeals affirmed the trial court's holding that the insurer's obligation under the policies' supplemental payments provisions, which promised to pay costs awarded against insureds, extended only to costs arising from claims that were at least potentially covered under the policy. Because there was no potential for coverage for the wage and hour claim, the fee award on that claim was not covered.

ALLEGED STRONG ODOR MAY BE "PROPERTY DAMAGE"

Essex Insurance Co. v. Bloomsouth Flooring Corp., 562 F.3d 399 (1st Cir. 2009)

In *Bloomsouth*, the First Circuit Court of Appeals considered whether a permeating odor qualifies as "property damage" within the meaning of a CGL policy. The underlying suit alleged, in part, that the insured was responsible for negligently and defectively installing carpet, resulting in an alleged unwanted odor throughout the building. The insured argued that it should be defended and indemnified

in the underlying action, because two of the underlying allegations were reasonably susceptible to the interpretation that they asserted claims of "physical injury." Those allegations were: (1) that an unwanted odor permeated the building, and (2) that the concrete floor in the building required "bead-blasting" (a type of abrasion). The First Circuit agreed with the insured, holding that these allegations could be interpreted as alleging "physical injury." Therefore, the First Circuit held that the insurer had wrongfully denied a defense to its insured.

KEY DEVELOPMENTS IN COVERAGE LITIGATION 2009: BAD FAITH

Kendall Hayden (Dallas), Aleksandr Pinkhas (New York), Kathryn Rutigliano (Philadelphia), and Josh Springer (Seattle)

INSURER'S PARTICIPATION IN SETTLEMENTS

Trinity Outdoor, LLC v. Central Mut. Ins. Co., 285 Ga. 583 (2009).

In *Trinity Outdoor*, on a certified question of law from the Northern District of Georgia, the Georgia Supreme Court found that, prior to bringing a claim against the insurer for negligent or bad faith failure to settle a case, a judgment must be entered against the insured in excess of the policy limits. Central Mutual Insurance Company insured Trinity Outdoor, LLC, and provided Trinity with a defense in a suit brought against Trinity when Trinity's billboard fell and killed two men. The decedents' family sued Trinity, and offered to settle for policy limits. During the court-ordered mediation, Trinity settled for Central's agreed-upon contribution, and Trinity also agreed to provide an additional amount without Central's permission. The insuring agreement provided that the insurer would only pay sums the insurer was legally obligated to pay, which did not include Trinity's voluntary payments. The Georgia Supreme Court found that Trinity could not bring an action for bad faith against Central for failure to settle in the absence of an excess verdict or an agreed-upon settlement.

Allstate Ins. Co. v. Miller, 212 P.3d 318 (Nev. 2009).

Miller, the insured, sued Allstate under three theories of bad faith liability: (1) failing to file an interpleader complaint; (2)

refusing to agree to a stipulated judgment in excess of the policy limits; and (3) failing to adequately inform Miller of a settlement offer. Allstate argued that it could not be liable for bad faith because it offered to pay the policy limits within 13 days of the insured's accident, and issued a check with the claimant and lienholders' names. The court agreed with the insurer on the first two issues, holding that an insurer does not have a duty to file an interpleader for its insured or to agree to a stipulated judgment that is beyond the policy's limits. However, it held for the insured regarding the third issue, finding that submission of the bad faith claim to the jury was not in error because bad faith can result from more than just an insurer's denial or delay in paying a claim, and can include the failure to adequately inform an insured of a settlement offer. Because Allstate could be liable for bad faith for its failure to adequately inform its insured of the settlement offer, the case was remanded for a new trial.

PRESUMPTION OF DEATH RELEVANT IN BAD FAITH DECISIONS

Malone v. Reliastar Life Ins. Co., 558 F.3d 683 (7th Cir. 2009)

Indiana law provides that a person is presumed dead after missing for seven years. In *Malone*, the insurer declined to pay benefits, because the insurer argued that the insured could not be "presumed dead" for a variety of reasons. The United States Court of Appeals for the Seventh Circuit,

finding for the insurer, held that the life insurer's refusal to pay policy benefits to beneficiary more than seven years after insured went missing did not demonstrate bad faith because parties had good faith dispute over whether insured was legally or actually dead.

Irby v. Fairbanks Gold Min., Inc., 203 P.3d 1138 (Alaska 2009)

In 1997, Irby, an employee, disappeared in an industrial accident. Despite Irby's employer's efforts, they could not locate his body. The Alaska Workers' Compensation Board denied Irby's wife's claims for benefits because she lacked proof her husband was dead. Irby's employer filed two controversies with the Board. Irby's wife filed a presumptive death petition in state district court. In 2003, the Bureau of Vital Statistics issued a presumptive death certificate. Thereafter, the Board awarded Irby's wife benefits, but denied her bad faith claim. The Supreme Court of Alaska held that Irby's employer had not acted in bad faith because it "raised colorable legal arguments" as to Irby's existence. Further, Irby's employer based its 2004 controversy on the statute of limitations, which the court held served as a good faith basis for a controversy.

NO BAD FAITH IF NO COVERAGE

Ganim v. Columbia Casualty Co., No. 08-3945 (6th Cir. July 23, 2009).

The plaintiff (Ganim, who was an employee of Legacy Financial Services) claimed that the insurer (Columbia Casualty Co.) committed bad faith by failing to defend him in an arbitration proceeding before the National Association of Securities Dealers ("NASD") brought by Vincent Santalucia alleging wrongdoing related to Ganim's personal financial services business. Columbia, Legacy's insurer, denied coverage, because the allegations did not involve Legacy's professional services, but rather Ganim's personal financial services, thus falling outside the scope of the Legacy policy's coverage. Ganim sued Columbia on multiple bad faith theories related to Columbia's denial of a defense before the NASD.

The District Court found that Columbia did not have a duty to defend Ganim because the allegations against Ganim did not fall within the scope of the policy's coverage related to Legacy's professional services. The Sixth Circuit agreed,

noting that the claim before the NASD did not contain allegations which "potentially" or "arguably" brought the claim within the policy's coverage. The court further found that Columbia did not act in bad faith, e.g. denial of policy benefits without a reasonable justification, because the claims before the NASD did not involve Legacy's professional services and thus were not potentially covered claims for which a defense was owed under the policy.

Chappell v. Kuhlman Electric Corp., 2009 Ky. LEXIS 252 (Ky. Oct. 29, 2009).

Kuhlman Electric Corporation ("Kuhlman") obtained workers' compensation insurance from Amerisure, but later became self-insured. When an injured employee brought a workers' compensation claim for an injury during an Amerisure policy period, Amerisure hired Landrum & Shouse ("Landrum"), to represent Kuhlman. During the course of the litigation, Landrum, on behalf of Kuhlman, as insured by Amerisure, filed a motion to join Kuhlman in its capacity as a self-insurer. When Kuhlman as self-insured was required to pay worker's compensation payments to Burgess, Kuhlman filed suit against Landrum for claims related to professional negligence and against Amerisure for bad faith.

The Kentucky Supreme Court found that there was a potential conflict of interest between Kuhlman as an insurer and Amerisure. However, even if Landrum had withdrawn, alternative counsel would have achieved the same result. Thus, Kuhlman could not demonstrate damages as a result of Landrum's actions, an essential element of its legal malpractice claims. Because Kuhlman could not maintain its malpractice action against Landrum, it also could not demonstrate that Amerisure acted in bad faith. The Kentucky Supreme Court found that summary judgment was properly granted for both Landrum and Amerisure.

MarkWest Hydrocarbon, Inc. v. Liberty Mut. Ins. Co., 558 F.3d 1184 (10th Cir. 2009)

After an explosion of a natural liquid gas pipeline, the operator was ordered to conduct a series of tests on its pipeline and to repair its integrity. The operator filed a claim with its insurance carriers seeking to recoup certain losses it incurred as a result of the explosion and the government's

mandated tests and repairs. The insurers denied coverage and the operator filed suit alleging bad faith denial of coverage. The Tenth Circuit Court of Appeals held that the insurance companies' denial of coverage was proper as a matter of law; therefore, the court held "we must also affirm the district court's grant of summary judgment in [insurer's] favor on... bad faith claim," because it is settled law in Colorado that a bad faith claim must fail if, "coverage was properly denied and the plaintiff's only claimed damages flowed from the denial of coverage."

NO BAD FAITH UNLESS DECISION NOT TO PAY IS "ARBITRARY AND CAPRICIOUS"

Dickerson v. Lexington Ins. Co., 556 F.3d 290 (5th Cir. 2009)

Dickerson's home was damaged by Hurricane Katrina in 2005. The damage involved serious flooding, including "extensive" evidence of damage from wind and rain, such as a hole in the roof. Dickerson submitted a claim to its insured for wind damage (the policy did not cover flood damage). Dickerson had reported the damage to the insured property in mid-September of 2005, and the insurer had sent an adjuster to inspect the damage on October 1, a month after Katrina. The insurer denied the claim.

Dickerson brought a diversity action against the insurer, alleging statutory bad faith for failure to timely pay for hurricane-caused wind and rain damage to the home. Under § 22:1220, an insurer owes its policyholder a duty of good faith in settling claims. Among the enumerated breaches of § 22:1220's duty of good faith is failure to pay a claim within 60 days following receipt of satisfactory proof of loss if that failure is "arbitrary, capricious, or without probable cause." Although the insured has the burden of proof under §§ 22:1220 and 22:658, once he has made his case, the burden of persuasion shifts to the insurer to rebut the insured's showing.

In this case, the Fifth Circuit Court of Appeals upheld the lower court's determination that there was "insufficient evidence presented at trial to support the finding that wind, rather than flooding, caused most of the damage to Dickerson's home." The court further held that since Dickerson failed to prove that the insurer's determination was an arbitrary and capricious withholding of payments, there was no bad faith.

BAD FAITH CAUSE OF ACTION LIMITED TO DENIAL OF BENEFITS UNDER THE POLICY

Rakes v. Life Investors Ins. Co. of America, 582 F.3d 886 (8th Cir. 2009)

After the insurer raised premiums rates, insureds filed a class action complaint alleging that the insurer used inflated lapse rates to purposefully underprice its long term care (LTC) insurance products and gain market share. The LTC policies were guaranteed renewable for life and included the option for increase of premiums based on premium class. The right to change premiums was stated on the first page of the policies, in boldface, capital letters. The United States District Court for the Northern District of Iowa granted summary judgment in favor of the insurer on claims of fraud and bad faith. The Court of Appeals affirmed. With respect to the appellants' claim for bad faith, the Eighth Circuit Court of Appeals held that "the tort of bad faith arises in situations where the insurer has denied benefits or has refused to settle a third-party claim against the insured within policy limits" and in this particular case, "plaintiffs have not made a claim for benefits under their policies."

NO ATTORNEYS' FEES FOR BAD FAITH

Jacobsen v. Allstate Ins. Co., 215 P.3d 649 (Mont. 2009).

Robert Jacobsen ("Jacobsen") sustained injuries in a car accident caused by Allstate's insured. Based upon Allstate's settlement conduct, Jacobsen filed suit against Allstate seeking compensatory damages for multiple claims, including common law bad faith. Jacobsen prevailed at trial, where the damages awarded included attorneys' fees for the underlying claim, but did not include any potential damages based upon emotional distress.

The Montana Supreme Court held that attorneys fees are not a recoverable element of damages in a claim for insurance bad faith, whether brought under the Montana Unfair Trade Practices Act or the common law, absent an exception to the American Rule. Because no exceptions applied, and the court was unwilling to extend the exceptions to allow attorneys' fees as an element of damages in the context of a third-party insurance bad faith claim, the court reversed the damages awarded by the lower court. The Supreme Court additionally found that a plaintiff is not required to make

a threshold demonstration of serious or severe emotional distress before a claim for emotional distress damages is allowed to go to the jury. The court remanded for a new trial

in which the jury would consider emotional distress as an element of damages.

KEY DEVELOPMENTS IN COVERAGE LITIGATION 2009: **PROPERTY**

Tyler C. Havey (Philadelphia) and Kellyn J.W. Muller (Cherry Hill)

SECOND CIRCUIT REVERSES SUMMARY JUDGMENT AWARD, CITING CONFLICT AMONG NEW YORK INTERMEDIATE APPELLATE COURTS CONCERNING THE MEANING OF "COLLAPSE"

Dalton v. Harleysville Worcester Mut. Ins. Co., 557 F.3d 88 (2d Cir. 2009)

In *Dalton*, the Second Circuit Court of Appeals ruled that the trial court erred in interpreting a first party policy's additional coverage for "collapse" as being confined to cases involving "total or near total destruction." Noting that there was disagreement among the intermediate appellate courts of New York as to whether a building must have suffered "near or total destruction" to be covered or whether coverage could arise due to a mere "substantial impairment of the structural integrity," the Second Circuit concluded that the policy's collapse language was capable of two reasonable interpretations. Because of this ambiguity, coverage was allowed where hidden decay had substantially undermined the structural integrity of the insured's property but had not yet caused it to fall. The Second Circuit also rejected the insurer's argument that, to be covered, the loss or damage must result from a "sudden" destructive force. The court noted that the policy covered loss or damage caused by "hidden decay," which was inconsistent with a requirement that the loss occur suddenly.

"ALL-RISK" POLICIES ARE NOT MAINTENANCE CONTRACTS

MarkWest Hydrocarbon, Inc. v. Liberty Mut. Ins. Co., 558 F.3d 1184 (10th Cir. 2009)

In *Mark-West*, The Tenth Circuit Court of Appeals ruled that the costs incurred by an insured to comply with corrective

action orders issued by the government following the failure of a bypass valve in a natural gas liquids pipeline are not covered by a demolition and increased cost of construction endorsement in all-risk property policy. While the question of coverage was largely decided on the basis of an exclusion for corrosion, the court's decision goes farther, explaining why a finding of coverage would be improper in light of the underlying purpose of "all-risk" insurance, which is to cover fortuitous losses. In particular, the court emphasized that "to read the policy as covering [the insured's] costs of complying with safety regulations would be to convert the parties' policy against unforeseen fortuities into a maintenance contract," which would have the unintended result of "misallocate[ing] the ordinary costs of doing business from the company to the insurer."

DWELLING IS "VACANT" AND "UNOCCUPIED" DESPITE OVERNIGHT STAYS ONCE EVERY TWO WEEKS FOR EXTENDED PERIOD OF TIME

Vushaj v. Farm Bureau Gen. Ins. Co. of Mich., 773 N.W.2d 758 (Mich. App. 2009)

Interpreting a standard vacancy provision providing that coverage was unavailable for loss occurring "while a described building, whether intended for occupancy by owner or tenant, is vacant or unoccupied beyond a period of 30 consecutive days," the Michigan Court of Appeals ruled that the terms "vacant" and "unoccupied" were commonly understood to mean that a dwelling was routinely characterized by the presence of human beings. Although the insured argued that the dwelling was "occupied" because his father typically spent one night every other week at the premises for two years, the court looked at the numbers from the opposite viewpoint, noting that the insured's father

slept elsewhere approximately 678 times over the course of the two year period. The court concluded that the use of the dwelling 52 times in two years did not constitute a dwelling routinely characterized by the presence of human beings. The court was also unpersuaded by the insured's argument that the presence of furniture kept the building from being "vacant" because it was not completely empty. Also figuring prominently in the court's interpretation was the overall purpose of the vacancy provision—nowhere to be found in the printed terms thereof—which the court found was to protect the insurer from the increase in hazard that accompanies unoccupied structures.

FORECLOSURE PROCEEDINGS DO NOT CONSTITUTE "INCREASE IN HAZARD" UNDER TENNESSEE LAW

U.S. Bank, N.A. v. Tennessee Farmers Mut. Ins. Co., 277 S.W.3d 381 (Tenn. 2009)

The policy in *U.S. Bank* contained a standard mortgage clause providing in part, that "[t]he mortgagee will...notify [the insurer] of any change of ownership or occupancy or any increase in hazard of which the mortgagee has knowledge." The benefits of the insurance policy under such clauses run to the bank holding the mortgage on the property. The bank foreclosed on the home, but failed to notify the property insurer of the foreclosure proceedings, during which the home was destroyed by a fire. The insurer subsequently denied the bank's claim, contending that the commencement of the foreclosure was an "increase in hazard," that the bank knew of the increase in hazard, and that coverage was invalidated by the bank's failure to notify the insurer of the commencement of the foreclosure. The Tennessee Supreme Court reversed the lower appellate court's decision granting summary judgment to the insurer, holding: "[w]e conclude that the Bank was not required to give notice to [the insurer] of the initiation of foreclosure proceedings, and therefore, the lack of notice does not invalidate coverage in this case.... We do not agree that by its plain meaning the phrase 'increase of hazard' includes the commencement of foreclosure proceedings."

LOSS OF FUNCTION DUE TO BLACKOUTS CONSTITUTES "PHYSICAL DAMAGE"

Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co., 968 A.2d 724 (N.J. Super. A.D. 2009), cert denied, 976 A.2d 385 (2009)

Following what appears to be a growing trend, the New Jersey Superior Court Appellate Division broadly construed the term "physical damage" in an all-risk policy to include loss of function and loss of use even though the loss was largely unaccompanied by actual physical loss or damage. Plaintiffs, all supermarket operators, brought an action against their insurer for loss of business and food spoilage resulting from the blackouts occurring in the northeastern United States and parts of Canada over a four day period in 2003. Reversing the trial court award of summary judgment in favor of the insurer, the Appellate Division concluded that "A 'Services Away from Covered Location Coverage Extension' extended coverage for consequential loss or damage resulting from an interruption of electrical power to plaintiffs' supermarkets where that interruption is caused by physical damage to specified electrical equipment and property located away from the supermarkets." The Appellate Division found that the term "physical damage" in the policy was ambiguous, that the trial court's construction of the term was both too narrow and inconsistent with the reasonable expectations of the insured and, contrary to the finding of the trial court, that there was physical damage within the meaning of the policy, because the electrical grid shut down due to a physical incident and was physically incapable of performing its essential function.

FIFTH CIRCUIT FINDS STORM SURGE NOT COVERED UNDER LOUISIANA LAW EVEN IF PERIL FALLS WITHIN POLICY'S DEFINITION OF "WIND/HAIL"

Arctic Slope Regional Corp. v. Affiliated FM Ins. Co., 564 F.3d 707 (5th Cir. 2009)

In *Arctic Slope*, the Fifth Circuit Court of Appeals held that, under Louisiana law, an all-risk commercial property policy's flood exclusion precluded coverage for damage caused by

a hurricane storm surge, even if coverage for storm surge fell within the policy's definition of the covered peril "wind/hail." After storm surge damaged the insured's property, and the insured acknowledged that winds were not responsible, the insurer denied coverage under the policy's exclusion for damage from floodwaters "whether driven by wind or not." The insured conceded that the exclusion encompassed storm surge damage, however, it contended that the loss nevertheless fell within a policy provision defining coverage for wind/hail damage as including "loss or damage caused when water, in any state... is carried, blown, driven, or otherwise transported by wind onto or into said location." The district court granted summary judgment in the insurer's favor and the Fifth Circuit affirmed, finding that even if storm surge falls within the definitions of both an excluded peril (flood) and a covered peril (wind/hail), the policy is not ambiguous when read as a whole because it explicitly states that it covers all risks of direct physical loss or damage "except as excluded under this policy." The Fifth Circuit concluded that the exclusion for storm surge as a flood event cannot be overridden by its possible inclusion as a wind/hail event. The Fifth Circuit also confirmed the enforceability under Louisiana law of the policy's anti-concurrent causation clause. The Fifth Circuit found that the clause was not ambiguous, and operated exactly as it was intended under a storm surge scenario. Citing its prior construction of similar or identical clauses under Mississippi law, the Fifth Circuit explained that the policy wording left no interpretive leeway to conclude that recovery could be obtained for wind damage that occurred concurrently or in sequence with the excluded water damage.

MISSISSIPPI SUPREME COURT REINTERPRETS THE ANTI-CONCURRENT CAUSATION CLAUSE

Corban v. United Services Automobile Assoc., 20 So.3d 601 (Miss. 2009)

The Mississippi Supreme Court, in a unanimous decision, held that a homeowner's insurer may be liable for a portion of the plaintiffs' more than \$1 million estimated cost for storm damages to their home from Hurricane Katrina. The decision addressed two important issues regarding post-Katrina claims. In favor of insurers, the decision approved

a lower court and prior federal decisions that held that a "water damage" exclusion precludes coverage for hurricane-driven water (also known as "storm surge.") However, the Supreme Court, contrary to two decisions of the United States Court of Appeals for the Fifth Circuit (*Leonard v. Nationwide Mut. Ins. Co.*, 499 F.3d 419 (5th Cir. 2007) and *Tuepker v. State Farm Fire & Cas. Co.*, 507 F.3d 346 (5th Cir. 2007)), determined that the "anti-concurrent causation" clause in the policy in question was ambiguous and did not preclude coverage for hurricane losses due to wind damage that happened in sequence with water damage. The court reasoned that, based on the record, the wind and flood acted sequentially and not concurrently, causing different damage and resulting in separate losses. The court further explained that the "anti-concurrent causation" clause would only apply to exclude coverage if the wind and water perils "contemporaneously converged, operating in conjunction to cause loss."

ELEVENTH CIRCUIT, INTERPRETING FLORIDA LAW, FINDS THAT A LATENT DEFECT COULD BE A MANUFACTURER'S DEFECT OR A DEFECT IN DESIGN

French Cuff, Ltd. v. Markel American Ins. Co., 322 Fed.Appx. 669 (11th Cir. 2009)

The insured filed a breach of contract claim against its insurance carrier based upon the carrier's denial of coverage for property damage to the insured's catamaran sailing vessel. The insurer contended that the loss was the result of a design or manufacturing defect (both excluded under the policy) and not loss arising out of a "latent defect" (which was specifically covered under the policy). The insured countered that, even if the defects at issue were manufacturer's defects or defects in design, they were also "latent defects," and thus covered under the "latent defect" exception to the manufacturer's defects or defects in design exclusion. Both parties filed competing summary judgment motions. The district court granted the insurer's motion and the insured appealed. The Eleventh Circuit reversed, finding that, under the plain language of the policy, the manufacturer's defects or defects in design exclusion does not apply if the manufacturer's defect or defect in design that caused the loss was also a latent defect.

FIRST CIRCUIT FINDS BAD SMELL CAN CONSTITUTE PROPERTY DAMAGE UNDER CGL POLICY

Essex Ins. Co. v. Bloomsouth Flooring Corp., 562 F.3d 399 (1st Cir. 2009)

The First Circuit Court of Appeals, applying Massachusetts law, held that unpleasant odors from carpeting installed by an insured that permeated a building constituted physical injury to property under a CGL policy. Specifically, the First Circuit found that odors can constitute physical injury to property under a CGL policy if the odor is “permeating or pervasive.” The First Circuit found that the odors were physical because they infiltrated the building and, according to the court, the infiltration qualified as “physical loss.”

NEW JERSEY APPELLATE DIVISION DETERMINES THAT PROPERTY POLICY COVERS CODE UPGRADES TO UNDAMAGED PARTS OF DAMAGED BUILDING

DEB Assoc. v. Greater New York Mut. Ins. Co., 970 A.2d 1074 (N.J. Super. A.D. 2009)

In a case of first impression, the New Jersey Appellate Division found that an insurer must pay for costs associated

with bringing undamaged portions of a building up to code standards after a windstorm damaged only one floor of the building. After a local code official inspected windstorm damage on the seventh floor of the building and discovered that the walls throughout the building had not been secured to the structure with appropriate steel fasteners, the official refused to issue a certificate of occupancy unless the owner brought the wall-to-floor connections on all eight floors up to code. Greater New York Mutual refused to provide coverage for the code upgrades, prompting the insured to file a declaratory judgment action. The trial court granted summary judgment to the insured and the Appellate Division affirmed, finding that a “clear causal connection” existed between the covered damage and the additional work ordered by the official because the windstorm damage on the seventh floor caused the authorities to look for and ultimately seek to remedy similar hazards elsewhere in the building.

RECENT VICTORIES: APPEALS

The team of **Bill Shelley** (Philadelphia), **Jack Cohn** (Philadelphia) and **Joe Arnold** (Philadelphia) won Third Circuit affirmance of the summary dismissal of a class action by medical providers challenging an automobile insurer’s use of computerized fee review software to adjust claims for medical reimbursement in *St. Louis Park Chiropractic v. Federal Insurance Co.*, No. 08-3808, 2009 WL 2171221 (3d Cir. July 22, 2009).

The complaint, brought on behalf of a putative nationwide class of medical providers in the Federal District Court for the District of New Jersey, sought to recover millions from Chubb for its allegedly improper use of a computerized

fee review database to reduce reimbursement payments to medical providers under no-fault automobile policies. The district court dismissed the case on the grounds that the claims were subject to mandatory arbitration and that common issues did not predominate.

Jack Cohn argued the appeal before a Third Circuit panel on June 1. On July 22, 2009, the Third Circuit unanimously affirmed the district court’s dismissal of the complaint on the alternative ground that the allegedly common issue, the mere use of computer fee-review software, did not even state a cause of action for breach of contract.

RECENT VICTORIES: TRIAL COURT

FAULTY WORKMANSHIP OF SUBCONTRACTOR NOT AN "OCCURRENCE" UNDER ARKANSAS LAW, FEDERAL JUDGE RULES

On January 7, 2010, an Arkansas federal judge held that faulty workmanship is not an "occurrence" covered by a commercial general liability policy. *Lexicon, Inc. v. ACE American Insurance Co., et al.*, No. 4:09CV00067 JLH, 2010 WL 79479 (E.D. Ark. Jan. 7, 2010).

Lexicon, Inc. sued ACE American Insurance Company and National Union Fire Insurance Company of Pittsburgh, PA, seeking a declaration that the insurers had a duty to indemnify Lexicon for its losses arising out of an industrial silo collapse in Trinidad, West Indies. ACE American issued a commercial general liability policy to Lexicon. National Union insured Lexicon under an umbrella policy.

Lexicon contracted with Nu-Iron Unlimited to supply 90-foot high silo storage bins at Nu-Iron's direct reduced iron facility in Trinidad, West Indies. Lexicon subcontracted the fabrication and erection of the silos to Damus Limited. After construction was complete, one of the silos collapsed, allegedly destroying the silo and other equipment, and damaging adjacent silos and the direct reduced iron product stored therein. Lexicon alleged that the collapse was unexpected and unforeseeable, and was caused by faulty welds performed by Damus.

Nu-Iron allegedly demanded that Lexicon repair and remediate the damage. Lexicon in turn demanded that Damus repair and remediate the damage. Lexicon agreed to subcontract with Damus to rebuild the collapsed silo for \$1 million, and Lexicon allegedly incurred millions of dollars in additional costs in mitigating Nu-Iron's other losses caused by the silo collapse and damage to the DRI. Lexicon sought insurance coverage under general liability insurance policies issued by ACE American Insurance Company, and by an excess insurer, National Union Fire Insurance Company of Pittsburgh, PA.

ACE American and National Union denied coverage to Lexicon for the loss. ACE American moved for summary judgment on the issue of whether the policies provided

coverage for Lexicon's alleged damages associated with the silo collapse. Among other grounds, it contended that Lexicon's claim arose from faulty workmanship, and not from an "occurrence" as required by the policy.

The ACE American policy defined "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." In his ruling, Judge Leon Holmes cited prior cases, *Nabholz Constr. Corp. v. St. Paul Fire and Marine Ins. Co.*, 354 F.Supp.2d 917 (E.D. Ark. 2005), *Essex Ins. Co., v. Holder*, 370 Ark. 465, 261 S.W.3d 456 (2008), and *Cincinnati Ins. Co. v. Collier Landholdings, LLC*, 614 F.Supp.2d 960 (W.D. Ark. 2009), as establishing that the purpose of a CGL policy under Arkansas law is not to insure every legal obligation that a contractor might incur, including the legal obligation of guaranteeing the workmanship of one's subcontractor, for which purpose performance bonds exist. Judge Holmes found that faulty workmanship is not an "occurrence" under a CGL policy and held that because Lexicon's claim was based on the faulty workmanship of its subcontractor, Damus, it did not constitute an "occurrence" and therefore was not covered by the ACE American policy.

Judge Holmes also granted summary judgment in favor of National Union, finding that, since the ACE American policy did not provide coverage as a matter of law, the National Union excess policy could not provide coverage for Lexicon's claim. ACE American Insurance Company is represented by [Richard C. Mason](#) (Philadelphia) and [Charles J. Jesuit, Jr.](#) (Philadelphia).

SELECTIVE TENDER RULE APPLIED IN WASHINGTON

With over \$4.1 million at issue, [Jodi McDougall](#) (Seattle) and [Molly Eckman](#) (Seattle) recently persuaded U.S. District Court Judge Zilly to dismiss Fireman's Fund on summary judgment in the notoriously policyholder-friendly Washington state.

Fireman's Fund issued 24 years of primary coverage to its insured. The insured tendered asbestos claims spanning multiple years to one policy year only. Fireman's Fund paid defense costs and per-occurrence limits on indemnity for

that policy year, and closed its claim file. The excess insurer made no payment. The insured sued the excess insurer, and the excess insurer asserted contribution claims against Fireman's Fund.

Jodi and Molly moved for summary judgment, relying on the selective tender rule in *Mutual of Enumclaw Ins. Co. v. USF Ins. Co.*, 164 Wn.2d 411 (2008). The excess insurer argued that the case was distinguishable based upon policy language,

but Judge Zilly disagreed. He confirmed that because Fireman's Fund owes no obligation to the mutual insured, Fireman's Fund likewise owes no further obligation to the excess insurer. Judge Zilly dismissed the contribution claims and, in doing so, confirmed that Fireman's Fund was not obligated to pay any of the \$4.1 million sought by the excess insurer who had hoped to obtain contribution from FFIC for other policy years.

NOTEWORTHY HONORS, APPOINTMENTS AND PUBLICATIONS

HONORS

Melissa O'Loughlin White (Seattle), co-leader of the Global Insurance Group's Appellate Practice Area, has been appointed to the Executive Committee of the King County Bar Association's Appellate Section. Members of the Section are appellate lawyers in the greater Seattle area who work closely with appellate courts throughout Washington state. Melissa's appointment places her in the line of succession to become president of the Appellate Section.

Kendall Hayden (Dallas) of the Global Insurance Group was selected as a member of the Board of Editors for the Texas Bar Journal 2009-2010 publishing year.

PUBLICATIONS

In the June 22 edition of California's Daily Journal, **Jacob C. Cohn** (Philadelphia) and **Joseph A. Arnold** (Philadelphia), with assistance from **Kathryn Rutigliano** (Philadelphia), published an article titled, "New Generation of Asbestos Trusts Encourages Double-Dipping."

COVERAGE ATTORNEYS "IN THE SPOTLIGHT"

PAST EVENTS

For a copy of materials or other related information, we invite you to contact the listed speakers at their respective offices at the numbers listed on the back page of this issue.

On April 3, 2009, **Jack Cohn** (Philadelphia) spoke at the American Bankruptcy Institute's Annual Spring Meeting, in National Harbor, MD., on the subject of "Third-party Releases, Exculpation Provisions, Plan Injunctions and Post-confirmation Jurisdiction."

On September 10, 2009, **Christopher Kende** (New York) moderated a panel consisting of in house lawyers at Swiss Re, ACE and Guy Carpenter on the topic of the reinsurance placement process at the HB Litigation Conference on Reinsurance Claims and Arbitration, sponsored in part by Cozen O'Connor, in New York.

On September 17, 2009, **Thomas McKay III** (Cherry Hill), **Michael Smith** (West Consohocken), **Kellyn Muller** (Cherry Hill) and **Charles Jesuit, Jr.** (Philadelphia) conducted a presentation entitled, "Chinese Drywall: Background, Scope and Insurance Coverage Implications." The seminar was held at the offices of QBE in New York.

On September 22, 2009, the Seattle office held an annual insurance seminar, addressing, among other issues, professional liability claims, fraudulent insurance claims, and issues arising from construction and marine claims. The seminar was coordinated by **Melissa O. White**. Speakers included **Jodi McDougall**, **Mark Anderson**, **Shauna Martin Ehlert**, **Molly Eckman**, **William Knowles**, **Eric Hanson**, **Rodney Fonda**, **Peter Mintzer** and **John Soltys**.

On September 24, 2009, **Rodney Q. Fonda** (Seattle) gave a speech to the RIMS Conference for the Western Region in Seattle, WA on "Piracy from a Marine Insurance Perspective."

On October 21, 2009, **Jodi McDougall** (Seattle) spoke in Philadelphia, PA at HB Litigation Conferences' All Sums Conference on "The Fundamentals: "All Sums" Versus Pro Rata Allocation, Terminology, and a Look Ahead."

On October 20 and 21, 2009, **Jack Cohn** (Philadelphia) spoke at the National Conference of Bankruptcy Judges in Las Vegas, NV on the subjects of "Post-Confirmation Litigation - The Latest Issues," and "Mass Tort Bankruptcy Update - Recent Events and the Impact of the Supreme Court's Decision in *Travelers v. Bailey*."

On November 11-13, 2009, **Rick Bortnick** (West Conshohocken) spoke at the PLUS Annual International Conference in Chicago, IL on the subject of "Executive Compensation, Corporate Governance, Global Warming: The Heat Is On!"

On November 16-18, 2009, **Rick Bortnick** (West Conshohocken) spoke in Hangzhou, China on the subject of "Mitigating Risks and Exposures in the US and EU Markets."

On December 10, 2009, **Jodi McDougall** (Seattle) was a panelist at a seminar sponsored by Lorman Education Service titled "Insurance Bad Faith Claims."

COZEN OFFICE "IN THE SPOTLIGHT"

The firm's Denver office offers a wide range of services for insurance company clients.

Chris Clemenson, in the Denver office, is the Vice-Chair of the Food Contamination Practice Group. Chris, who joined Cozen O'Connor in 2005, is a Member of the firm. In addition to his experience in food contamination matters, Chris advises clients on a variety of insurance coverage and bad faith matters, including those arising out of construction defect claims, patent, trademark and trade name infringement claims, environmental claims, and other general liability claims. Additionally, he advises clients on

UPCOMING EVENTS

We invite your attendance at the following events. For information, you may contact the speaker at his or her office at the numbers listed on the back page of this issue.

Rick Bortnick (West Conshohocken) will speak at the Counsel on Litigation Management Annual Conference, "Enhancing Efficiencies and Cooperation in the Defense Relationship," on March 24 - 26, 2010. Ponte Vedra Beach, FL. <http://www.litmgmt.org/annual-conference/default.aspx>.

Rick Bortnick (West Conshohocken) will present at the HB Litigation Conferences, "NetDiligence Cyber Risk & Privacy Liability Forum," June 7 - 8, 2010, in Philadelphia, PA. <http://email.litigationconferences.com/display.php?M=3159425&C=44a93e325a910cc5465d8cfc9d9e40a0&S=65&L=95&N=68>,

Rick Bortnick (West Conshohocken) will be a presenter at the University Risk Management and Insurance Association Annual Conference, "The How's and Why's of the Rising Costs of EPL Litigation," October 9-13, 2010, in Pittsburgh, PA. <https://www.urmia.org/annual/2010/>

first-party coverage issues, including claims made under commercial property policies and builder's risk policies.

Chris was named to the 2009 edition of *The Best Lawyers in America* in the category of Insurance Law.

Although he specializes in insurance coverage and bad faith litigation, Chris also has significant experience in complex commercial litigation, including construction defect litigation, product liability defense, and defense of governmental and religious institutions.

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