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Perspectives
on Insurance Recovery

pillsbury

Welcome to our latest Insurance Recovery newsletter. We open with a look back at the 100-year-old decision that settled insurance coverage claims from the 1906 San Francisco earthquake and fire. The decision was not only a win for Pillsbury, it presaged the ongoing split among U.S. states on policies regarding "concurrent causation"; that is, the granting of coverage to an insured when a loss is caused by excluded perils (such as earthquakes or hurricanes) and insured perils (such as fires or winds).

We also take a look at newer issues we have worked on and matters of the moment, such as coverage questions arising from the massive earthquake and nuclear crisis in Japan.

Article Highlights

For more information, please contact:

Peter M. Gillon, Washington, DC
202.663.9249
peter.gillon@pillsburylaw.com

Robert L. Wallan, Los Angeles
213.488.7163
robert.wallan@pillsburylaw.com

Old Wines, New Battles: Lessons from the Great Fire of 1906

California Wine Association v. Commercial Union Fire Insurance Company of New York

by Rene L. Siemens and Peter M. Gillon

December 2010 marked the centennial of the landmark California Supreme Court decision that resolved the critical insurance coverage dispute arising from the 1906 San Francisco earthquake and fire. The earthquake and ensuing fires laid waste to the city, destroying 28,000 buildings and causing the nation's second-largest death toll in history with up to 6,000 killed.

Immediately after the fires were extinguished, the city's real estate board convened to pass a remarkable resolution that "the calamity should be spoken of as 'the Great Fire' and not as 'the Great Earthquake.'" Why? Many fire insurance policies issued to San Franciscans contained exclusions for losses caused by earthquake. As British consul general Walter Courtney Bennett put it, "If the insurance is not paid, the city is ruined. If it is paid, many of the insurance companies will break."

Many policyholders were forced to sue their property insurers when they invoked earthquake exclusions to deny coverage. Policyholders won some cases and lost others, but the decisions helped set the ground rules for how courts around the country would resolve insurance disputes arising out of such catastrophes up to the present day. Addressing the perplexing issue of coverage when loss is caused by two perils—one that is insured and one that is excluded—most courts held that there was coverage for the ensuing fires unless the insurance policies unambiguously excluded fires caused by earthquakes. Even where the policies excluded losses "caused directly or indirectly by earthquake," most courts found for the

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claimants if any covered cause independent of the earthquake—an explosion, backfiring or even wind—contributed to the fire damage.

These early decisions helped establish the now nearly universal rule of "concurrent causation" or "efficient proximate causation." In layman's terms, this means that when a loss is caused by a combination of excluded causes (earthquake, flood) and covered causes (fire, hurricane), the insured is entitled to coverage.

Skillful Representation for Policyholders

The 1906 case illustrates how these rules work in the hands of skilled policyholder lawyers and was filed by the California Wine Association, which stored millions of gallons of wine in San Francisco warehouses. After fire consumed these buildings, the Wine Association submitted to its insurers a property damage claim that included loss of inventory. Commercial Union Fire Insurance Company of New York denied coverage, invoking the exclusion in its policy for "loss caused directly or indirectly by earthquake." The insurance company's lawyers argued that the fire had been started by the earthquake and traveled "continuously and uninterruptedly" to the plaintiff's warehouses, destroying them.

The Wine Association's attorneys obtained the judge's approval to ask the jury specific questions in the form of special verdicts. One asked whether, of all the fires that began on April 18, some were "not caused directly or indirectly by the earthquake." Another asked whether it was necessarily one of these latter fires that destroyed the Wine Association's warehouses.

The jury answered these questions in favor of the Wine Association after its lawyer showed, to the jury's satisfaction, that the losses were caused by fires from the quake that were legally distinguishable. (Hours after the quake struck, for example, someone making breakfast on a stove sent sparks through a cracked chimney and launched what is known as the "Ham and Eggs Fire.") The insurer appealed, but to no avail. On December 28, 1910, the California Supreme Court held that the jury's factual finding made the only potential legal issue in the case moot, namely, whether the fire had been caused by the earthquake or had independent origin.

The California Legislature later enshrined the decision in *California Wine Association v. Commercial Union Fire Insurance Company of New York*, amending the state's insurance code to mandate that property insurers must cover fire damage ensuing from earthquakes regardless of whether those fires are "caused" by earthquakes or merely "follow" them. Across the country, insurers sought to protect themselves from a repeat of the massive losses they had incurred in the wake of the 1906 San Francisco catastrophe by inserting so-called "anti-concurrent causation clauses" into nearly all of their property insurance policies. Those clauses say, in essence, that if damage occurs even partly by an excluded cause, there is no coverage even if a covered cause also contributes to the loss. In California, such clauses remain unenforceable to this day.

A Continuing Issue in Natural Disaster Claims

The concurrent causation issue has continued to rear its head in almost every dispute over insurance coverage for natural disasters. Indeed, the issue became critical nearly 100 years later in the litigation over coverage for property damage resulting from Hurricane Katrina. While most property insurance policies excluded flood damage, windstorm loss was generally covered. Many Katrina claims have yet to be resolved, but most Gulf state courts have found anti-concurrent causation clauses to be enforceable, denying policyholders coverage for billions of dollars in windstorm damage that was exacerbated by ensuing floods.

In contrast, partly as a result of the tragic events a century ago, California remains one of only a handful of states that refuse to recognize and enforce such anti-concurrent causation provisions. As companies contemplate the potential hazards presented by natural and man-made disasters, it is worthwhile to revisit the issue of concurrent causation and the tragedies that can result when coverage is not available for such perils.

During the past year, this issue has been presented in stark relief, with a Haitian earthquake, a Pakistani flood and a three-month drought in Russia. For the majority of policyholders, deleting anti-concurrent causation clauses from their policies will remain a matter requiring hard-knuckled negotiation. Fortunately, at least for now, California policyholders retain the protection granted by the State Supreme Court in 1910.

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IN THE NEWS

Recent Pillsbury Representations

- A hospitality company and a guitar manufacturer on insurance claims relating to the 2010 Nashville flood.
- A major U.S. airline in its claims arising from the 2011 Japan earthquake and tsunami and the 2010 eruption of the Eyjafjallajokull volcano in Iceland.
- A significant stakeholder in pursuing coverage rights under multiple insurance programs for claims arising from the Deepwater Horizon oil spill.
- A for-profit education company on D&O insurance coverage claims arising out of a shareholder lawsuit.

To learn more about our practice, please contact Peter M. Gillon at 202.663.9249 or email peter.gillon@pillsburylaw.com.

Construction Risk Management:

Top 10 Issues in Construction Contracts

by James P. Bobotek

The success of construction lenders, owners, contractors or subcontractors may depend on how well each of them addresses project risks. This is called "risk management." A major part of risk management is "risk allocation," whereby a party assigns by contract the responsibility for a certain risk to another party, who will then bear that risk. Yet another part of risk management is the manner in which a party handles its assumed risk so that the possibility (and resulting cost) of the risk is minimized.

Some of the most important risk management tools at a party's disposal are the contracts into which it enters with others involved in the construction project. Within those contracts, risk is primarily allocated through indemnity and insurance requirement provisions. Managing risks can be handled not only by sound business and construction practices (such as proper preconstruction planning, proven construction means and methods, use of experienced personnel, and stringent safety programs) but also by careful contract preparation and review. What follows is a brief overview of some of the key risk allocation and risk management concepts to consider when preparing or entering into your next construction contract.

Allocating Risk to the Party That Is in the Best Position to Control That Risk

A fundamental risk management concept is that owners and contractors should anticipate potential project risks and determine whether it is more advantageous to accept responsibility for each risk or to allocate responsibility for that risk to another party. From a risk management perspective, it is important to assign a project risk to the party best able to control and manage it. For example, a project owner will want to allocate the risk that someone is hurt by construction operations to the contractor, who is in the best position to provide a safe work site. A contractor will want to allocate the risk of design errors to the owner, who often holds the contract with the architect and therefore is in a better position to address and minimize these losses. These are the types of risks that a construction contract should address, so that the parties know in advance who is responsible for what risk.

Allocating Risk Through Indemnity Provisions

An indemnity provision generally is a section in a contract that requires one party to pay for losses incurred by the other party (and, often, to defend the other party against claims for such losses) as a result of claims made by third parties. Following up on the risk allocation example set forth above, a construction contract indemnity provision often requires the contractor to indemnify and defend the owner from and against claims for bodily injury and property damage that arise from the negligence of the contractor or one of its subcontractors while performing the work. Another indemnity clause may require the owner to indemnify and defend the contractor from and against claims based on the existence of hazardous materials on the project site over which the contractor has no control.

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Construction Risk Management

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Backing Up Indemnity Provisions With Insurance

Contractual indemnity provisions included in contracts are only as good as the indemnitor's ability to honor them. The indemnitor must have the financial ability to satisfy its indemnification obligations. Accordingly, when transferring risk through an indemnity provision, it is important to ensure that the transferee (or the indemnitor) has, or is able to procure in a cost-effective manner, insurance coverage sufficient to pay for the assumed indemnity obligations. One caveat to this general principle is that some risks allocated in an indemnity provision, such as liability arising out of an indemnitor's intentional misconduct, are not insurable due to moral hazard and/or public policy considerations. The lack of insurability for such conduct, however, does not necessarily constitute a valid argument for not requiring the indemnity—the party best able to control the loss should be the one indemnifying the other party from and against that loss, regardless of whether insurance is available to backstop the indemnity.

Insurance Is a Fundamental Way to Manage Risk

If a party has responsibility for a type of loss on a project, it will want to obtain insurance for that loss to minimize its costs, should the loss be realized. Accordingly, when preparing insurance requirements for construction-related contracts, it is important to identify and address the risk obligations associated with each project discipline and to make sure that the limits are adequate to address possible losses.

Design Professionals

Contract insurance requirements for design professionals (e.g., architects, engineers, etc.) should include auto and commercial general liability; workers compensation/employers liability; and, most importantly, professional liability insurance. The limits of design professionals' professional liability coverage are particularly important. Because a professional liability policy typically will cover losses arising on all of a design professional's projects, not just your project, it is important that the aggregate limit be sufficiently high. Indeed, owners often consider requiring excess limits for professional liability coverage or requiring that the coverage be "project specific" either through a separate project policy or sublimits applicable only to the project. For large projects, an owner also may wish to consider obtaining owners protective professional liability insurance coverage, which indemnifies the owner directly for losses arising out of the design professional's professional negligence that exceeds the limits available under the design professional's own professional liability policy.

Contractors and Subcontractors

Those contractor and subcontractor entities performing construction work on the project should be required to carry automobile liability, commercial general liability (CGL) and workers compensation/employers liability policies, as well as an excess liability policy providing coverage over the automobile and CGL policies' limits. For those contractors and subcontractors performing any design-build functions, professional liability coverage also should be required. To prevent coverage gaps, contractors' and subcontractors' insurance requirements should include pollution liability coverage. If the owner will procure the property or builder's risk coverage, as discussed below, contractors and subcontractors should consider the need for an "installation floater" or similar coverage to protect their equipment and supplies on-site, off-site, and in transit.

Property/Builder's Risk Coverage

While the liability coverage referenced above covers most project accidents resulting in (i) bodily injury and (ii) damage to property other than what is being constructed, in most cases it does not cover damage to the structure being built or the materials being used. This damage, however, can be covered by obtaining a "builder's risk" policy. While it is sometimes possible to cover damage to construction projects under an owner's existing property policy, there are coverage limitations in standard property insurance forms that make procurement of a builder's risk policy desirable in most cases. If a builder's risk policy is procured, consideration should be given to whether the owner or the contractor obtains it. This determination is best made on a project-by-project basis, taking into consideration such factors as the type of project (e.g., new construction or renovation of an existing structure), type of contract (cost plus or stipulated sum), financing/lender's requirements (owner may want to "bundle" soft cost and loss of income coverage with the builder's risk policy to avoid claim delays and argument among insurers over coverage), the presence of a master property program (owner or contractor), location of project, the parties' relative economic leverage to negotiate the most favorable premium and coverage, the contractor's level of sophistication, and the owner's desire to participate in project-specific risk management. That being said, it is more common for owners than contractors to purchase builder's risk insurance, which covers the interests of all of the other parties having an interest in the project.

Surety Bonds Are Also Used to Manage Risk

The risks of nonperformance and of nonpayment are shared by owners, contractors and subcontractors of all tiers. Both of these risks can affect the timely and on-budget completion of the project. For this reason, owners often require contractors to post a performance bond, which typically obligates the issuer of the bond (known as the "surety") to complete the project if the contractor is terminated, and a payment bond, which typically obligates the surety to make payments due from the contractor to subcontractors if the contractor does not do so. Likewise, contractors will require payment and performance bonds from subcontractors to mitigate the risk of subcontractor nonperformance and failure of subcontractors to pay sub-subcontractors or suppliers. In some instances, contractors will use "subcontractor default insurance" that will reimburse the insured contractor for damages incurred as a result of the subcontractor's failure to perform.

Addressing Potential Insurance and Bond Coverage Gaps

As discussed above, many risk management products, including insurance policies and bonds, are required to cover the risks presented by a construction project. Insurance policy provisions are drafted to create in one policy the exact coverage that is excluded by another policy. To the greatest extent possible, the coverage provided by these policies should fit together. It is therefore wise to have an insurance broker and/or attorney review the entire risk management program to identify gaps in coverage and to suggest amendments, endorsements and additional coverage to close these gaps.

Adding Protection by Including Additional Insured Requirements

Owners and contractors should require all downstream contractors and/or subcontractors to add the owner and contractor as an additional insured under the downstream parties' liability policies. Additional insured status adds a layer of protection not only to an owner's or contractor's indemnity requirements but also to its own insurance coverage. A key advantage to being an additional insured is that the insurer has an up-front duty to defend claims made against additional insureds, whereas most indemnity provisions require only that the indemnitee provide reimbursement of any defense costs. When drafting additional insured provisions, it is often advisable to include a requirement that the additional insured endorsement be broad enough to cover both ongoing and completed operations, as well as the additional insured's liability arising out of the work, on a primary and noncontributory basis. Be sure, however, not to ask to be named as an "additional named insured," as this may impose undesirable obligations such as paying a deductible, self-insured retention or premium if the first named insured fails to do so.

Ensuring That Waivers of Subrogation Are in Place

Including waivers of subrogation ensures that many project risks are properly transferred from the contracting parties to their insurers. Basically, such provisions prevent insurers from passing risk back to downstream project parties by precluding insurers from seeking reimbursement from other project participants for amounts paid on claims. Because an insurer "stands in the shoes" of its insured when bringing a subrogation claim, it cannot bring such a claim if its insured has waived this right in its contract with the allegedly culpable party. For this reason, waivers of subrogation ensure that transferred project risk stays with the insurers.

Don't Rely on Certificates of Insurance

Many parties to a construction project fail to adequately confirm that the project insurance requirements have been satisfied, either upon execution of the contract or throughout the duration of the project. Required coverage limits, additional insured status and waivers of subrogation provide no benefit if they were not obtained or are permitted to lapse. Owners and contractors frequently rely on a cursory review of certificates of insurance to "confirm" compliance with insurance requirements. This practice is risky, as many insurance certificates include incorrect and/or incomplete information, such as omitting mention of risk-changing exclusions or endorsements. In addition, most certificates of insurance are prepared using an industry-standard form. Courts have found that these forms are so replete with express disclaimers that they are not legally binding on the party providing them. As such, it is advisable to require in the contract not only a certificate of insurance evidencing the proper insurance coverage, additional insured status and waiver of subrogation but also delivery of applicable endorsements (if not the full policies themselves) evidencing such coverage. Performing a diligent review of the information provided will greatly diminish, if not remove, the anguish, costs and lost time suffered upon discovery, after a claim is made, that the coverage identified in the certificate of insurance in fact is not what the actual policies provide and is not what is required under the relevant contract.

Before Signing, Have Contracts Reviewed by a Knowledgeable Attorney and Read Contracts for Consistency

Each construction project includes multiple contracts, all of which should be consistent and complementary. For example, dispute resolution provisions should be harmonized so that all parties involved can be in the same proceeding at the same time; this will avoid inconsistent results that may arise if there are several different cases addressing the same issues. Project lenders' and owners' requirements regarding payment timing and limitations should be properly flowed down into all project contracts so that payment provisions are consistent throughout the contracts. In addition, many lenders, owners and contractors use form contracts with insurance and indemnity requirements that are outdated, unenforceable or otherwise unobtainable. Forcing a party to obtain insurance in a form that is no longer offered, or offered only at a cost-prohibitive premium, is not in the project's best interest. To avoid these problems, it is crucial to have an experienced attorney review the contracts. Just as important, there is no substitute for each party reading its contract very carefully before signing. Beyond the obvious problems of errors and inaccurate information that creep into negotiated contracts, careful review may reveal additional risks, improperly allocated risks and other issues that a lawyer, who often is not as familiar as the client with the project, would not catch. Remember always that few agreements are perfect and that vigilant contract review is one of the most crucial steps in the risk management process.

English Law: Coverage of Asbestos Exposure Hinges on Wording in Employers' Liability Insurance

by Raymond L. Sweigart

The English courts continue to wrestle with the issues surrounding which policies of insurance, if any, must answer in both the public or commercial liability and employment contexts for alleged exposure to asbestos causing illness years later.

In the consolidated appeal of *Mesothelioma "Trigger" Litigation*, [2010] EWCA Civ 1096, the English Court of Appeal was called on to consider when insurance coverage for mesothelioma claims under employers' liability policies is triggered and whether the policy to respond to such claims is the one in place when the asbestos particles were inhaled on the job or the one in place at the onset of a disease that can emerge up to 35 years after inhalation.

The two policy wordings in question in the *"Trigger"* appeal differ slightly, but, essentially, one provided coverage for "injury sustained" and the other for "disease contracted" during the policy period. As will be seen below, this difference in wording was central to the outcome of the appeal.

The Appellate Decision

The Court of Appeal found that mesothelioma is not an "injury" that is "sustained" until onset of the disease. The Court clearly felt bound by the earlier Court of Appeal decision in *Bolton MBC v. MMI* [2006] concerning mesothelioma under a public liability policy. It was determined that liability for injury or illness "occurring within the policy period" is not triggered when the claimant was exposed to asbestos fibers, as no injury or illness had occurred at that point. Instead, liability attaches only when malignancy develops or when the symptoms first become apparent.

Lord Justice (LJ) Rix did not say in so many words that *Bolton* was wrongly decided, but he suggested that had he not been bound by this precedent, he would have preferred the view that the risk of mesothelioma that is created by the exposure is an injury. Burnton LJ, however, found *Bolton* convincing. Both Rix LJ and Burnton LJ (Smith LJ dissenting) rejected the first instance judge's decision that this construction would be in conflict with the commercial purpose of employers' liability insurance. Accordingly, they found that injury had not been sustained at the date of inhalation, and appellants with that policy form prevailed.

All three Lord Justices agreed that "disease contracted" in the other policy form referred to the time of the disease's causal origins or the date of exposure. Rix LJ commented that the commercial purpose of the policy should prevail on this issue, and Burnton LJ differed that little assistance could be gained by referring to the commercial purpose of the policy. Accordingly, the appellants with this policy wording lost.

One further argument raised was that the policies only applied to employees in the course of their employment and did not apply to ex-employees. At first instance the judge held that this point favoured a construction that cover was intended to be the date of causation in all cases. Smith LJ agreed with the judge; Rix LJ agreed that the wordings did not apply to ex-employees but felt that this did not point to a causation trigger; and Burnton LJ held that certain wordings did apply to ex-employees.

Permission to appeal to the Supreme Court on all the above issues has been granted, and it is understood that argument has been scheduled for December 2011.

Commentary

Rather than adopt the "triple trigger" (exposure, onset, manifestation) followed in many U.S. jurisdictions, linking coverage only to the date of "onset" under the "injury sustained" policy wording is both impractical and of questionable merit as a policy. The date of causation (that is, exposure) can often be determined, but victims will in most cases only learn that they are suffering from mesothelioma some time later when they seek medical care for symptoms that become apparent. Onset was found to be usually "around 5 years" before manifestation, but determining the exact date of onset as a coverage trigger will be extremely imprecise in most cases.

The first instance judge suggested the adoption of a *prima facie* rule of five years before manifestation to address this; however, that was not argued on appeal. Nevertheless, no matter how or when "onset" is determined, if at that point the employer has become insolvent or is no longer in business, there will be no policy in place that can be called on for coverage, and claimants will be left without recourse unless the Financial Services Compensation Scheme might apply. If the employer is in existence and solvent, it will be deprived of the benefit of insurance coverage for which it had paid. One might query whether, as a matter of sound policy, the Supreme Court on the further appeal and/or government by legislation will in the end favor the Court of Appeal's approach to an "onset" trigger or even an alternative "manifestation" trigger, which could leave both employers and victims without any redress to insurance coverage.

Causation Questions

Predicting where the *"Trigger"* appeal will come out is further complicated by the recent Supreme Court decision in *Sienkiewicz v. Greif* (UK) Ltd [2011] UKSC 10. There it was noted that the unusual features of mesothelioma had led to the development of a special test of causation for the disease, as it is frequently impossible for a claimant to prove causation according to the conventional "but for" test. The case of *Fairchild v. Glenhaven* [2002] had provided a cause of action "against a defendant who has *materially increased* the risk that the claimant will suffer damage and may have caused that damage, but cannot be proved to have done so because it is impossible to show, on a balance of probability, that some other exposure to the same risk may not have caused it instead" [Lord Hoffmann, with emphasis added].

Sienkiewicz considered which causation test applies in a "single exposure" case (where the claimant alleges only one possible tortious source for the asbestos exposure). Is it the *Fairchild* test ("materially increased the risk") or is it an alternative "doubles the risk" test (i.e., must it be shown that the exposure for which the employer was responsible has more than doubled the environmental exposure). In this case, it was proven that this particular employer had only increased the claimant employee's exposure over general environmental asbestos exposure by a mere 18%. The Supreme Court unanimously held that the special rule established in *Fairchild* applied. There was no room for a "doubles the risk" approach. This was the case even though, as Lord Brown recognized, the result is liability in full for one responsible for only a small proportion of the claimant's overall exposure to asbestos dust.

Does *Sienkiewicz* suggest that exposure, since it can result in full employer liability, should be the trigger for insurance coverage? We will have to wait and see.

Pillsbury Adds Marquee Team of Insurance Coverage Attorneys

Pillsbury's litigation practice has added a marquee team of insurance coverage attorneys with significant experience in the construction sector, adding depth that will help us better serve our clients. These strategic additions continue the expansion of the firm's capabilities in construction litigation and transactions and enhance our strengths in energy, real estate, project finance and insurance recovery.

Led by David T. Dekker and Melissa C. Lesmes, the group of four partners and five associates represents builders, engineering firms, developers and private equity funds in insurance coverage disputes. This talented and accomplished group focuses on construction-related insurance coverage litigation, including builder's risk, general and professional liability, and pollution claims. The insurance team is part of a group of 14 former Howrey attorneys who recently joined our Los Angeles; San Francisco; Washington, DC; and New York offices. The group is top-ranked by *Chambers* and other national legal rating services and has been described in the press and by *Chambers* and *Legal 500* as being among the very best construction lawyers in the United States.


David T. Dekker


Melissa C. Lesmes

Insurance May Cover Class Action Costs for Merchants Who Recorded Customers' Zip Codes

by Robert L. Wallan and Kimberly L. Buffington

The California Supreme Court's February 10 decision in Pineda v. Williams-Sonoma *has already spawned a wave of class action lawsuits, many of which may constitute covered losses under a business's Directors and Officers (D&O) or Commercial General Liability (CGL) insurance policies.*

In *Pineda v. Williams-Sonoma Stores, Inc.*, the California Supreme Court considered whether a business violates California's Song – Beverly Credit Card Act of 1971, Civil Code section 1747, et seq. (the "Credit Card Act") when it requests and records a customer's ZIP code during a credit card transaction. Under Credit Card Act section 1747.08, a business may not condition the acceptance of a credit card as payment for goods or services on a requirement or request that the cardholder provide personal identification information.

The *Pineda* court unanimously held that retailers abridge the Credit Card Act when they ask credit card customers for ZIP codes. The Court reasoned that because ZIP codes constitute personal identification information, requesting and recording that data violates the Credit Card Act. In the decision, the Court noted that defendant Williams-Sonoma added each cardholder's name and ZIP code to its database and used that information to "market products" and subsequently sell the compiled information. The Court further held that in enacting the Credit Card Act, the legislature sought to prevent retailers from improperly using personal and private data for marketing purposes.

Following the Court's decision, a handful of plaintiffs' lawyers have filed more than 50 cases against retailers. Generally, the lawsuits contain allegations that the retailers wrongfully obtained private ZIP code information and used the information for advertising, promotion and marketing. The lawsuits seek excessively high damages, including up to $1,000 per violation of the Credit Card Act, as well as attorneys' fees, costs of suit and prejudgment interest.

The nature of the claims, the lack of quantifiable harm and the massive nature of potential damages under the Credit Card Act are closely similar to a wave of recent lawsuits under the federal corollary to the Credit Card Act, the Fair and Accurate Credit Transactions Act of 2003 (FACTA). Under FACTA, plaintiffs' lawyers also targeted retailers in hundreds of FACTA class actions across the country. Many of these defendants were able to defeat class certification or settle FACTA claims for nuisance value, but an equally important consideration was the question of whether insurance companies would provide coverage for these claims.

In our experience, many FACTA defendants successfully obtained insurance coverage defense cost reimbursement and indemnity under D&O or CGL policies. Like many of the FACTA class action claims, the claims asserted in the Credit Card Act class actions may also be covered under a business's D&O or CGL policy. While each policy must be individually evaluated, private D&O policies often cover a range of broadly defined "wrongful acts" that encompass the allegations in these Credit Card Act class actions. Likewise, CGL policies may also provide coverage for the Credit Card Act class actions because these policies frequently cover personal or advertising injuries arising out of violations of a victim's right of privacy as well as other types of advertising injuries.

Insurance coverage questions are fundamentally contract questions that require careful consideration of the specific policy in question in addition to legal precedent. Given that class actions can be costly to defend and settle, a careful evaluation of insurance coverage and pursuit of denied claims can be a cost-effective strategy.

In order to avoid risking a loss of coverage, businesses sued in Credit Card Act class actions should promptly notify their insurance carriers of the claim. Moreover, businesses should not be deterred by an initial coverage denial. In our experience, although insurance carriers frequently initially denied coverage for FACTA class actions, insurance coverage for those cases was secured under both D&O and CGL policies.

Are Nuclear Accidents Covered?

by Rene L. Siemens

Recent events in Japan have focused attention on whether nuclear accidents in the United States would be covered by insurance. For decades, insurers have denied coverage for the costs of investigating and cleaning up radioactive contamination. Insurers insist that such costs are excluded from coverage. Their position took a body blow recently when a Massachusetts federal judge ruled in favor of a Pillsbury client that the "pollution exclusion" that has been contained in nuclear liability insurance policies since at least 1990 is unenforceable as a matter of law.

Nuclear Liability Policies

Comprehensive general liability (CGL) and property insurance policies have contained "nuclear exclusions" for over sixty years. These exclusions are not as comprehensive as sometimes assumed, but since the late-1950s, pools of insurance companies have been formed to fill the gaps in traditional insurance for radioactive contamination. One pool called American Nuclear Insurers (ANI) has a monopoly on liability insurance policies designed to cover the "nuclear energy hazard." Many nuclear facility operators and others are required by federal law to purchase ANI's policies to cover their liability risks. Other companies that handle radioactive material voluntarily purchase ANI's policies.

Unfortunately, ANI's position is that environmental contamination caused by releases of radioactivity from insured facilities is not covered by its policies. In light of ANI's insistent denial of coverage over the last several decades, many companies no doubt assume that insurance is simply not available for their costs of remediating environmental contamination caused by such releases. They are wrong.

The "Pollution Exclusion"

In the 1980s, courts around the country started holding that CGL policies covered the costs of complying with environmental cleanup demands made by federal and state regulatory agencies, as such demands were the equivalent of covered "suits" for "damages." CGL insurers responded by adopting the "absolute pollution exclusion" in 1986.

ANI decided to take a different approach. In 1990, instead of adopting the absolute pollution exclusion, ANI drafted a standard endorsement for nuclear liability policies that affirmatively promised to pay for "covered damages" and "covered environmental cleanup costs because of environmental damage." ANI then circulated a memorandum to insurance brokers and state insurance regulators explaining that its endorsement was a "restatement of the present coverage for property damage liability claims in a new format" and describing it as providing enhanced environmental coverage, or (in ANI's words) "new coverage for certain environmental cleanup costs."

But buried in the middle of ANI's new 10-page, single-spaced, standard-form endorsement were a series of "definitions" that ANI would later argue actually excluded coverage for almost all environmental response costs that an insured might incur to investigate or remediate radioactive contamination related to any insured facility.

The Nuclear Metals Claim

In 2005, Whittaker Corporation demanded that ANI pay its costs of responding to a U.S. EPA order that required it to investigate and remediate radioactive contamination related to the Nuclear Metals Superfund site in Concord, Massachusetts. The Nuclear Metals facility had started in the 1950s as an offshoot of the Manhattan Project and the Massachusetts Institute of Technology before it became involved in the manufacture of depleted uranium munitions. Many years later, the state and federal environmental protection agencies ordered Whittaker to characterize and clean up radioactive contamination related to the facility that the agencies had determined resulted from decades of releases of radioactive material.

ANI invoked its 1990 endorsement to deny coverage. Whittaker then filed suit, seeking a declaration that ANI had a duty to defend and indemnify it against EPA's cleanup demand. The lawsuit raised for the first time whether the current, standard nuclear liability insurance policy form used in the United States covers the costs of responding to environmental contamination from radioactive material.

The Nuclear "Pollution Exclusion" Held Unenforceable

In a series of decisions issued in late-2009 and 2010, Judge Richard G. Stearns sided with Whittaker, ruling that ANI's

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"pollution exclusion" endorsement was unenforceable as a matter of law because it "was not properly issued" [*Whittaker Corp. v. American Nuclear Insurers*, 671 F. Supp. 2d 242, 252 (D. Mass. 2009).] In issuing the endorsement, the judge explained, ANI had failed to "give clear notice to [the] insured of a loss or reduction of coverage" [*Id.]*. ANI fought this decision tooth and nail, but the court issued two subsequent decisions denying ANI's motions for reconsideration and reiterating that it was "clear from the record" that in issuing its endorsement—which, remember, apparently promised to pay for "covered damages" and "covered environmental cleanup costs because of environmental damage"—ANI had failed to clearly "explain" to its insureds that ANI actually intended to eliminate practically all coverage for environmental damage caused by radioactive material.

The court's conclusion was based on a state statute, Mass. Gen. Laws Ch. 175, § 111A, which provides that when an insurer reduces or eliminates coverage, it must send the insured a printed notice clearly explaining how its coverage is being affected; otherwise, the policy's original coverage "shall remain in full force and effect without such reductions and eliminations." Most states similarly protect policyholders from insurers' attempts to reduce coverage surreptitiously by requiring insurers to accompany exclusionary endorsements with clear, easy-to-understand notices that explain the intended effect of any endorsement or retroactive exclusion. Therefore, the ruling in the Nuclear Metals case potentially renders the "pollution exclusion" in every nuclear liability insurance policy that has been issued in the United States void and unenforceable as a matter of law.

The "Owned Property" Exclusion Inapplicable

Of course, the fact that the "pollution exclusion" in nuclear liability policies may be unenforceable as a matter of law does not mean that all costs of remediating radioactive contamination are automatically covered. In connection with the Nuclear Metals claim, for example, ANI also denied coverage on the grounds that its policy excluded coverage for on-site contamination (as opposed to contamination that has migrated off-site). As Judge Stearns noted, however, the case law under similar "owned property" exclusions in CGL policies establishes that as long as there is an imminent threat that on-site contamination will migrate into groundwater or adjacent property, then such exclusions will not preclude coverage for costs of investigating and remediating the on-site radioactive contamination that are incurred to prevent its spread. *Id.* at 254-55.

The court concluded that ANI should at a minimum be required to pay Whittaker's costs of defending itself against EPA's cleanup demand because there was a threat that radioactive contamination would migrate to adjacent property, and EPA already had found that groundwater contamination had taken place. *Id.* at 255. He further held that ANI can escape its duty to indemnify Whittaker for the ultimate cost of the cleanup only if it turns out that no such threat actually exists [*Id.* at 255 n.27.]

Lessons Learned

In light of the groundbreaking Nuclear Metals decision, operators of nuclear facilities and other insureds under nuclear liability insurance policies should consider pursuing coverage for environmental investigation and cleanup costs—even if their coverage claims have previously been denied. The "pollution exclusion" in nuclear liability insurance policies should be unenforceable as a matter of law, not just in Massachusetts but in any state that requires insurers to explain clearly to their policyholders what the insurer is up to when it adds policy provisions it intends to use later on to deny coverage. In addition, most environmental contamination involves at least the threat of migration off-site or into groundwater. For that reason, the cost of cleaning up radioactive contamination also should usually be covered under nuclear liability insurance policies.

Pillsbury Named One of the Top Insurance Groups of 2010

Pillsbury is pleased to announce that the Insurance Recovery & Advisory practice was named one of the top five insurance groups of 2010. This recognition by *Law360* was based on the legal publication's review of more than 300 law firms. A team of four editors selected the top five based on significant wins in insurance lawsuits in 2010.

Pillsbury's Insurance Recovery & Advisory practice is one of the oldest in the country, *Insurance Law360* reports, citing the precedent-setting California Supreme Court case that Pillsbury won 100 years ago in the aftermath of the 1906 earthquake in San Francisco. "A hundred years later, Pillsbury is still involved in some of the headline-grabbing cases of today," said practice co-leader Peter M. Gillon.

The practice is handling insurance disputes arising from such recent disasters as the Gulf of Mexico oil spill, the Eyjafjallajokull volcano eruption, Hurricane Ike and record-setting flooding in Nashville, Tennessee. The practice has unique experience in several areas, Gillon said, including insurance insolvencies, environmental liability, directors and officers insurance, and nuclear liability coverage.

In another of the practice's high-profile cases, partner René L. Siemens achieved victory for client Whittaker Corp. in a coverage dispute with American Nuclear Insurers. "The decision is important as it is the first time a court construed the pollution wording in a nuclear policy, potentially affecting other nuclear insurance claims around the country," Siemens said.

"We are proud of this recognition," said Robert L. Wallan, the Insurance Recovery & Advisory practice's co-leader. "We continue to strive to grow our practice strategically and build on the firm's top-tier practices in energy, IP, environment, and technology, to name a few."

Preparing Your Business for the 2011 Atlantic Hurricane Season

by Vince Morgan

The Atlantic Hurricane Season officially runs from June 1 to November 30, though peak activity usually occurs in August and September. With the beginning of tropical storm activity just around the corner, now is the time to prepare your company and review your insurance coverage for what may lie ahead in the coming months.

Consensus Predictions for 2011

While estimates from various forecasters differ, the consensus predictions at this time expect a relatively average hurricane season this year with about 12 to 14 named storms, roughly 6 or 7 of which may become hurricanes, with perhaps 2 to 4 developing into intense hurricanes. Even one storm, however, may be enough to cause massive losses.

Steps to Prepare Your Company

Though it is impossible to predict precisely if, and where, this year's storms may make landfall, it is prudent for companies with significant exposure to the Eastern and Gulf coast regions to prepare as if a storm is headed their way. With that approach in mind, here are some steps that can be taken now to prepare ahead of time, which should be part of the company's disaster and business continuity plan.

Review Your Policies, and Adjust Them If Necessary

The time to review your company's policies is now, not after a storm has passed. Scenario planning is an excellent way to identify potential gaps in coverage as well as challenges the company might face in the aftermath of a storm. For example, preparing a hypothetical claim for a Category 3 storm at a key facility should present a fairly realistic picture of potential losses and how the policies will likely respond. To the extent that this process identifies any deficiencies in coverage, or perhaps asset schedules and related policy information that needs to be updated, now is the time to take care of these details to avoid disputes in the future.

Understand Key Coverages

- **Protecting the Company's Property:** A company's commercial property policy is usually the starting point for protecting its tangible property. Ensuring that the policy carries adequate limits, based on a current fixed-asset verification, is critically important. Additionally, the policy should be carefully examined for exclusions, deductibles and internal sublimits that may reduce available proceeds. Further, some policies also place conditions on where insured property can be located to be covered, such as within a certain distance from a covered location.
- **Protecting the Company's Income:** Covering tangible property itself is usually not enough to make most businesses whole in the aftermath of a natural disaster. It may take weeks, months—even years—to fully restore the company's revenue produced by these assets. Thus, there are a number

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Preparing Your Business for the 2011 Atlantic Hurricane Season

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of "time element" coverages that serve to protect against such losses. These include:

- **Business Interruption Coverage:** "Business interruption" coverage protects a company against the revenue lost as a result of covered damage to the company's own property. For example, if a hurricane causes damage to a company's facility, which then results in downtime while the property is being repaired or rebuilt, business interruption coverage provides protection against this lost revenue.
- **Contingent Business Interruption Coverage:** Hurricanes typically cause widespread damage to affected areas. As a result, a company's key suppliers or customers might also suffer outages that affect the company's ability to conduct its normal business operations. Contingent business interruption coverage protects against losses due to these disruptions.
- **Civil and Military Authority Coverage:** In the aftermath of a disaster, and occasionally beforehand with approaching storms, government authorities may issue evacuation orders and other constraints on access to certain areas. After the September 11 terrorist attacks, parts of Manhattan were off limits for several days. Likewise with Hurricanes Katrina and Rita. Most commercial property policies provide coverage for losses arising out of prohibitions against access due to orders from a "civil or military authority."
- **Service Interruption Coverage:** Service interruption coverage is designed to protect against losses that result from the interruption of utilities such as water, power, communications or similar services.

Prepare for Initial Post-Storm Activities

Steps taken in the immediate aftermath of a storm are critical to preserving and maximizing a company's insurance recovery, as well as ensuring that the company's business levels return to normal as quickly as possible. From the standpoint of insurance, these steps include: (i) notifying all carriers in accordance with the policies; (ii) forming a claims team, utilizing both internal personnel from the risk management, operations, legal and accounting functions, as well as external claim consultants and coverage counsel; (iii) setting up separate accounts to track post-claim losses and expenses incurred in the recovery efforts; and (iv) establishing and observing effective claim management procedures to avoid disputes and streamline the process, such as preservation of the carrier's salvage rights, protecting covered property against further loss, and seeking advances against the ultimate loss payment.

Hurricanes Can Wreak Havoc on Your Business, but the Insurance Process Doesn't Have to Be Stormy

Hurricanes that make landfall often cause enormous damage. Having a properly managed insurance recovery process, however, can mitigate a storm's impact on your business.

For more information, please contact:

Kimberly L. Buffington
Los Angeles
213.488.7169
kimberly.buffington@pillsburylaw.com

David T. Dekker
Washington, DC
202.663.9384
david.dekker@pillsburylaw.com

Peter M. Gillon
Washington, DC
202.663.9249
peter.gillon@pillsburylaw.com

Geoffrey J. Greeves
Washington, DC
202.663.9228
geoffrey.greeves@pillsburylaw.com

Melissa C. Lesmes
Washington, DC
202.663.9385
melissa.lesmes@pillsburylaw.com

Vince Morgan
Houston
713.276.7625
vince.morgan@pillsburylaw.com

Rene L. Siemens
Los Angeles
213.488.7277
rene.siemens@pillsburylaw.com

Robert L. Wallan
Los Angeles
213.488.7163
robert.wallan@pillsburylaw.com

Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | 877.323.4171 | www.pillsburylaw.com