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WIGGIN AND DANA

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# Insurance News

A NEWSLETTER FROM THE INSURANCE PRACTICE GROUP AT WIGGIN AND DANA LLP

SUMMER 2009

*We are pleased to introduce the inaugural issue of the Wiggin and Dana Insurance Practice Group Newsletter.*

*Our intent is to circulate this newsletter by e-mail periodically to bring to the attention of our colleagues in the insurance industry reporting on recent developments, cases and legislative/regulatory actions of interest, and happenings at Wiggin and Dana.*

*We welcome your comments and questions.*

For more information about the content of this newsletter, please contact our Editor and Insurance Practice Group Attorney, Rachel Priester.

## ATTORNEY NOTES

**CHUCK PLATTO** will be teaching Insurance Law at Fordham University School of Law in the fall of 2009.

**MICHAEL MENAPACE** will be teaching Insurance Law at the Quinnipiac University School of Law in the 2009/2010 school year.

**JOSEPH G. GRASSO** acts as general counsel to the American Institute of Marine Underwriters and the Inland Marine Underwriters Association. In that capacity, Joe has been involved in drafting policy forms and filing amicus briefs on behalf of those organizations.

**CHUCK PLATTO** has been appointed to serve as a vice chair of the ABA-TIPS Insurance Coverage and Litigation Committee and chair of its Academics Subcommittee.

**JOSEPH G. GRASSO** has been recognized in the 2009 Edition of Who's Who Legal, in the section of Shipping and Maritime.

## CHINESE DRYWALL – IT'S NOT ARMAGEDDON. BUT WHAT IS IT?

*By Michael Menapace*

A rash of lawsuits have recently been filed for alleged damages due to drywall originating from China. As with every new type of class or mass action suit brought by the plaintiffs' bar, the question always posed is whether this is the next asbestos, a tidal wave of litigation with potentially devastating exposure. Unless some new evidence emerges or the alleged fact pattern changes, the answer appears to be "No, Chinese drywall is not the next asbestos." Nor does it appear to be the next silica, welding rod, or even mold litigation.

The implications of these Chinese drywall suits are still evolving, and the ultimate scope of the litigation remains to be seen. However, we suggest that insurers take note because issues raised in the Chinese drywall lawsuits implicate a number of lines of coverage, both personal and commercial.

## The Product, the Allegations, and the Science

Drywall was imported to the U.S. from China in increasing quantities when the demand for building materials soared during the housing boom, and domestically made drywall was difficult to obtain. One builder, Miami-based Lennar Corp., admits noticing issues with drywall installed in homes it built beginning in 2005. Consumers have lodged large numbers of reports describing problems with home air-conditioning systems and other electrical appliances. Apparently, the suspect drywall, imported from China, has been emitting (or "off-gassing") a sulfur compound that can interact with some materials, including copper in air conditioning systems, causing corrosion of wiring and coils and, ultimately, system failure. Lennar has already set aside about \$39 million to repair 400 houses it has inspected, removed the offending drywall and replaced it — a costly process.

While the Florida Department of Health says that test levels in the affected homes do not indicate an immediate health threat, the unpleasant sulfur odor certainly is making some inhabitants nervous and frustrated. A recent report from the federal Environmental Protection Agency estimates that the sulphur content in the Chinese drywall can be as much as ten times the content found in American-made drywall. Florida Congressman Robert Wexler has written to Florida Governor Charlie Crist with reports of children experiencing bronchitis, pneumonia, and other severe respiratory conditions that have purportedly required hospitalization. These reports have led some U.S. Senators to propose a temporary ban on certain Chinese drywall imports or a recall. Both federal and state agencies are investigating.

## Litigation Outlook

While federal and state governments consider the allegations, many lawsuits have already been filed, as has been well chronicled in news reports. Most complaints originate from

## **PUBLISHED PIECES**

In February, 2009 for the first time ever, two satellites collided in outer space. The space insurance industry is a multi-billion dollar industry, but determining fault in a space collision is considerably more complicated than in collisions in air, on sea or on land due to both physical limitations and the legal framework governing space operations. In *When Satellites Collide: Commercial Ventures Beware*, published in *Space News* on April 1, 2009, Alison M. Weir considered some challenges facing those who might seek to collect damages in the event of another satellite collision.

Wiggin and Dana recently submitted an *amici curiae* brief in the Connecticut Supreme Court in the case *Brown and Brown, Inc. v. Blumenthal* (SC 18334) on behalf of several industry groups. The Property Casualty Insurers Association of America, The American Insurance Association, The National Association of Mutual Insurance Companies, The Insurance Association of Connecticut, and The Connecticut Business and Industry Association engaged the firm's insurance, antitrust, and appellate lawyers to submit a brief on their behalf arguing against the Attorney General's plan to disclose to the public and competitors confidential and proprietary business information, including information received from third-party insurance clients and others in connection with an antitrust investigation, without notice or the opportunity for judicial review.

the Southeastern United States, although other regions of the country have seen some activity, reflecting estimates that Chinese drywall has been installed in as many as 41 states. As expected in these types of high-volume, high-profile cases, class-action complaints already have been filed in Florida, Louisiana, Alabama, North Carolina and Mississippi. Most plaintiffs to date have sued the manufacturers, installers, and others associated with the use of the drywall, but we have also seen homeowners filing claims under their homeowner policies and suing their insurers when those claims are denied. One constant among all these actions is that various types of insurance coverage are implicated, and we can expect litigation testing whether coverage is afforded under those policies.

Even though scientists already have stated that beyond a nasty smell, the sulfur emissions are not acutely toxic, plaintiffs' lawyers will, no doubt, look to sue builders, suppliers and manufacturers. With estimates that more than ten million square feet of Chinese drywall was imported into southwest Florida alone during the 2004-2005 building boom, and a reported 309 million square feet of drywall overall imported from China from 2004-2007, lawsuits likely will be common and far-reaching, as these numbers represent a small fraction of the total amount of drywall used during that period.

Generally, the suits claim that the defendants negligently manufactured and sold defective drywall causing, among other things, corrosion of air-conditioning and electrical components, and medical effects, including coughing and sinus, eye, and throat irritation. The lawsuits generally allege breach of contract and breach of express and implied warranties because the drywall was "unreasonably dangerous" in normal use. The insurance implications for these construction and product liability suits are discussed below.

Separate from the pending lawsuits against builders and related entities, some homeowners have taken matters into their own hands rather than waiting for the class actions to be resolved. In this category of cases, the homeowners have filed claims under their personal lines policies and have had them rejected. The homeowners are consequently filing bad faith claims against their insurers for failure to cover these claims. Moreover, in addition to traditional homeowner claims, we expect that condominium owners will look to their condominium associations for relief, potentially implicating those associations' policies.

Finally, D&O claims likely will follow. Companies named as defendants in the Chinese drywall suits may face D&O claims if their share prices drop as a result of these previously undisclosed liabilities. (For example, Lennar's stock dropped 19% recently after it disclosed the lawsuits in an SEC filing.)

## **Insurance Implications**

For issuers of commercial policies, one question is whether these suits are sufficiently similar to other mass tort or liability cases such that we can apply the lessons learned from those cases and better predict the extent of potential defense and indemnification obligations of insurers.

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**INSURANCE NEWS | SUMMER 2009**

Unlike with asbestos and silica, sulfur gases emitted from the drywall do not seem to be associated with long-term health effects. Also, because the drywall was apparently all installed within the past few years, the relatively short exposure time is also unlike the asbestos and silica scenarios, restricting the potential number of policies and policy periods that may be affected.

Some people have compared these cases to mold. While this comparison may be attractive at first glance, the drywall cases principally allege strict products liability, defective construction and/or negligence, and breach of contract-type causes of actions, while mold litigation mostly has focused on personal injury and negligence causes of action. In personal injury cases, plaintiffs must prove causation, which can be a challenging burden. Because the drywall cases are pled as products liability cases, the defendants may have to defend against strict liability theories of recovery. What we can draw from the mold litigation, however, is the cost of remediation and likely impact areas. Like mold, areas with newer housing stock and housing stock with large amounts of renovations (for example, following recent major hurricanes) will be hardest hit. Therefore, we can expect jurisdictions in the Sunbelt to be the main battlegrounds, with smaller exposure in other areas.

Manufacturers and installers will likely look to their CGL insurers to defend and indemnify them against these drywall claims. Home builders, who may be Additional Insureds on subcontractors' policies, may look first to those policies for primary coverage before making a claim on their own policy, depending on the particular state's law with regard to completed operations coverage. Careful examination should be made on the issue of completed operations coverage, as the law varies from state to state. Moreover, the language on standard forms has changed significantly over the past decade with regard to completed operations. Certainly, if initial policy limits are exhausted, umbrella or excess policies may see claims made, given the anticipated scope of the problem.

As with any other complex claims issues, coverage suits will ensue. In one coverage case pending in Virginia, an insurer who issued a commercial package policy and an umbrella policy to a builder has relied on several exclusions to disclaim coverage. In that instance, the insurer is claiming that three exclusions preclude coverage: (1) the total pollution exclusion; (2) an exclusion for "your work"; and (3) an impaired property exclusion.

Other exclusions will be tested. "Your product" exclusions may be at issue, particularly for manufacturers and others involved in the manufacturing process. The applicability of pollution or contamination exclusions is already being tested in at least one suit filed in the Middle District of Florida with regard to homeowner policy claims. In that case, after the insurer denied coverage, the homeowners filed a complaint against a unit of the insurer seeking coverage under their policy, claiming that the insurer failed to disclose or produce the results of inspections and tests conducted on the home. The insured's complaint asserts that the gases emitted from the Chinese drywall are not "contaminants," and therefore, the "pollution or contamination" exclusion does not apply.

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## ABOUT WIGGIN AND DANA'S INSURANCE PRACTICE GROUP

The Wiggin and Dana Insurance Practice Group represents insurers and reinsurers in a broad range of complex and sophisticated, as well as routine, commercial and personal lines insurance and reinsurance matters. The group provides advisory, regulatory, coverage, defense and general litigation, arbitration, dispute resolution services in individual and class actions, as well as investigative, appellate, and expert witness representation. We provide advice and representation on regional, national and international matters. A more detailed description of the Insurance Practice Group, and biographies of our attorneys appear at [www.wiggin.com](http://www.wiggin.com).

## ABOUT WIGGIN AND DANA LLP

Celebrating our 75th Anniversary in 2009, Wiggin and Dana is a full service firm, with 135 attorneys, serving clients domestically and abroad from offices in New York, Connecticut and Philadelphia. For more information on the firm, visit our website at [www.wiggin.com](http://www.wiggin.com).

*Please feel free to send us the names and e-mail addresses of colleagues who would like to receive this publication. If you do not want to continue to receive a copy of this publication, please contact Brenda Jacobson ([bjacobson@wiggin.com](mailto:bjacobson@wiggin.com)).*

## INSURANCE NEWS | SUMMER 2009

Another lesson from mold cases is that exclusions may minimize future exposure for insurers of homeowners. Under most homeowners policies now in use, coverage for mold is either capped or completely excluded. A similar exclusion or cap could be added by endorsement to address the Chinese drywall problem.

While defense and indemnity for product liability claims may be excluded under commercial lines policies, we do know that claims of a foul odor that permeates a building can be construed as a physical injury to property, and that claimed loss of use because of the odor can be covered under insurance policies. Recently, the First Circuit Court of Appeals in Massachusetts ruled that the presence of a permeating odor can constitute physical injury under Massachusetts law and that exclusions for business risks do not necessarily eliminate an insurer's duty to defend. In that case, the offensive odor came from newly-installed carpet. The court stated, "[a]llegations that an unwanted odor permeated the building and resulted in lost use of the building are reasonably susceptible to an interpretation that physical injury to property has been claimed."

In addition to exposure for litigation and defense expenses, it is possible that Chinese drywall may need to be removed, disposed of, and replaced. Additionally, internal wiring and plumbing may need to be replaced. [Obviously, none of this work is inexpensive, but it would pale in comparison to the amounts paid out to asbestos, silica, or tobacco plaintiffs.] Insurers will have to decide whether to defend lawsuits, settle claims, and/or proactively assist in the resolution (i.e. pay for the removal and replacement), and insurers also will have to consider whether to adopt changes in policy language to address future claims and limit future exposure.

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## FROM THE COURTS

**New York court dismisses insureds' maritime suit on forum non conveniens grounds.** *Cavlam Business Ltd. v. Certain Underwriters at Lloyd's*, 2009 WL 667272 (S.D.N.Y. March 16, 2009). In *Cavlam*, Judge Koeltl granted underwriters' motion to dismiss on forum non conveniens grounds. Joseph Grasso and Aaron Singer of Wiggin and Dana represented the prevailing underwriters.

The yacht AMIRA sank in Venezuela in December 2004. The AMIRA was insured by a policy underwritten by certain underwriters at Lloyd's of London. The insured owners, who purchased the yacht in Florida and dealt with a Maryland-based insurance broker, were a French citizen permanently residing in the Bahamas and a non-operating British Virgin Islands corporation, of which the Frenchman was the sole shareholder. (The locales would make even James Bond dizzy.) When the AMIRA sank, its owner was in Paris and professed no knowledge of how it sank. The underwriters denied the claim on the basis of at least one surveyor's opinion that the yacht's owners failed to keep her seaworthy.

The underwriters filed an action in the High Court in London seeking a declaration that the sinking was not covered by the policy. After acknowledging service of the English action, the insured owners filed a competing suit in the Southern District of New York. The underwriters moved to dismiss on three grounds: forum non conveniens; the

existence of a forum selection clause in the policy; and international comity. The Court granted underwriters' motion based on forum non conveniens, thereby finding it unnecessary to address the two latter grounds. The Court focused on the Second Circuit's decision in *Iragorri v. United Tech Corp.*, 274 F.3d 65 (2d Cir. 2001) (en banc), which set forth a three-step framework for resolving a motion to dismiss based on forum non conveniens, essentially ruling for the underwriters on all three parts of the framework. First, the court concluded that the plaintiff's choice of forum was due "little deference" in this case, where the plaintiff-insureds had "no apparent connection to the United States in general or to New York in particular." *Id.* at \*3. The court also concluded that the lawsuit itself was "unmoored" (who can resist a good yacht pun?) from the United States and from New York. The insureds' explanation that they were motivated by tactical concerns related to deposing experts did not provide a bona fide connection to the forum. Second, the court concluded that an adequate alternative forum — London — exists. Third, the court balanced public and private convenience and interest factors, concluding London was a more convenient forum than New York.

Finding New York inconvenient, the Court dismissed the case in favor of parallel proceedings pending in London. This decision effectively precludes the insureds from claiming punitive damages for alleged bad faith by the underwriters.

**Connecticut Appellate Court grants title insurer's motion for summary judgment on duty to defend and bad faith claims.** *Heyse v. Case*, 114 Conn. App. 640 (June 2, 2009). In *Heyse*, the Connecticut Appellate Court concluded that a title insurance policy did not provide coverage for a dispute about subdivision rights between the insured and a neighboring landowner. Plaintiff Heyse challenged the right of the Cases to subdivide a lot in a common interest community. The community was created in 1991, and a declaration was recorded. Ms. Heyse purchased her lot, with title insurance, in 1993. A Connecticut state statute allowed Ms. Heyse and other landowners to enforce a section of the community's declaration stating that, with some exceptions, no lot's boundaries may be changed unless all landowners in the community consented. In 2005, the Cases sought subdivision approval for their lot without obtaining Ms. Heyse's consent, citing a special development right under an "other provisions" section of the declaration.

Ms. Heyse objected to the subdivision and wanted her title insurer to foot the bill for her quest. The insurer relied on two exclusions: (1) an exclusion for matters "attaching or created subsequent to Date of Policy"; and (2) an exclusion for loss, damage, costs, fees, and expenses relating to the 1991 community declaration.

The court struggled somewhat with the first exclusion. The insurer argued that the exclusion clearly applied because the 2005 effort to subdivide the property was "subsequent to" the 1993 title policy. Ms. Heyse argued that because the putative subdividers based their right on the terms of the 1991 declarations, that problem existed prior to the purchase of her lot and was barred by the "subsequent" exclusion. The trial court was persuaded by the insurer's position, but the Appellate Court disagreed, construing what it felt to be an ambiguity against the insurer. However, the insurer still prevailed because the second exclusion, barring claims relating to the 1991 community

declaration, unambiguously barred Ms. Heyse's attempt to have the insurer pay for her claim relating to the 1991 community declaration. The Court also granted summary judgment in favor of the insurer on a bad faith claim, concluding Ms. Heyse had not provided sufficient evidence for her bad faith claim and declining to infer bad faith where the evidence presented did not support that inference.

**Minnesota court rejects selective tender rule.** *Cargill Inc. v. Ace Am. Ins. Co.*, No. A08-1082 (Minn. App. May 26, 2009), considered selective tender and privity between multiple primary layer insurers.

After Cargill was sued for alleged pollution relating to Cargill's poultry operations in Oklahoma and Arkansas, it made a claim on only one of its primary insurers. (Because the suits' allegations concerned several decades and multiple locations, more than 50 primary insurers' policies were potentially available for contribution.) The primary insurer tendered to Cargill a loan receipt agreement that essentially said that the primary would front the costs of defense, but that Cargill either had go after its other primary insurers for contribution or assign its right to do so to the defending insurer. Cargill refused, taking the position that an insured could select a primary insurer to fully and exclusively defend a claim because each insurer "owes a separate and distinct obligation to pay defense costs," and it was not obligated to allow that single insurer to pursue other insurers for contribution. That is, Cargill relied on the doctrine of selective waiver, where, if the insured prevailed, that single insurer would be stuck with the whole defense bill. The insurer can't force the policyholder to make a claim on other insurers, and it can't sue the other insurers directly. In some states, selective waiver is accepted as legitimate.

Answering a certified question, the Minnesota Court of Appeals took a different tack. Although the Court agreed that the insurer could not pursue direct contribution claims against other insurers for lack of privity, principles of good faith and fair dealing and the cooperation clause in Cargill's policy with the insurer whom it selected both require Cargill to "cooperate by entering into a neutral loan receipt agreement that equitably apportions liability between primary insurers." The court heavily considered the equities of the case and explicitly rested its decision in part on "policy reasons." In particular, the court feared that "[w]ithout preserving the opportunity to recover an equitable apportionment of defense costs among insurers who have yet to tender a defense, insurers would be at the mercy of the insured who could unilaterally select an insurer or insurers to defend. Such a policy would undoubtedly cause insurers to adopt [a] 'wait and see' approach," contrary to the policies expressed in previous case law. Here, given the insured's refusal to sign the loan document, the court imposed a constructive loan receipt agreement. A dissenting judge complained that the court improperly set policy and ignored the absence of contractual privity and each individual insurer's own obligation to provide a defense.

**Coverage afforded because insurer conducted too much investigation.** *Koegler v. Liberty Mut. Ins. Co.*, No. 08-CV-7645 (S.D.N.Y. April 21, 2009). In a counterpoint to cases alleging insurers failed to investigate a claim sufficiently before issuing a disclaimer, the

*Koegler* Court ruled against an insurer because it conducted too much of an investigation. *Koegler* held that because the complaint on its face alleged injuries arising from transmission of a communicable disease, and the relevant policies “contain an explicit exclusion for action arising out of the transmission of communicable diseases,” the insurer’s disclaimer of coverage 40 days after it received notice of the claim was untimely. Judge McMahon therefore ruled that the insurer had a duty to defend its insured.

During the 40 days between receipt of notice and issuance of the disclaimer, the claims handler obtained copies of the expired policies to review them, “consulted with supervisors about the enforceability of certain exclusions under New York law,” and sought coverage opinion from outside counsel. The court did not think the investigation was necessary and felt the insurer should have pulled the trigger sooner. “Insurers should be cautious when disclaiming coverage. But in this case, the applicable policy exclusion[s] are so obvious that they either were or should have been readily apparent to the claims handler. The complaint in the Underlying Action alleged transmission of a communicable disease. Both of *Koegler*’s policies contained exclusions for just such a claim.” The court also rejected the insurer’s argument that the exclusion was seldom implicated; “claims for transmission of communicable disease apparently occur with enough frequency that Liberty Mutual finds it prudent to include a communicable disease exclusion in standard form policies.” (We will leave the social commentary to others.) Ultimately, the court decided it was “unreasonable as a matter of law for the claims handler to undertake a coverage review, because the basis for the disclaimer was or should have been readily apparent at the onset of the delay.”

Perhaps as a concession to the harsh result, Judge McMahon also described New York as “an exceedingly pro-insured jurisdiction. Again and again its Legislature and courts hold insurers’ feet to the fire, penalizing them for the slightest misstep. This is just such a case.”

**Pollution exclusion held to be ambiguous.** *Janart 55 West 8th LLC v. Greenwich Ins. Co.*, 06 CV 14293 (CSH) (S.D.N.Y. May 6, 2009). In *Janart*, the Court considered whether costs related to a mercury spill and remediation fell within a landlord’s all-risk property insurance policy’s pollution exclusion.

The source of the mercury, fifteen pounds of which leaked into one apartment through a hole in the ceiling, took some detective work. After some investigation, the insured concluded that a dentist who had occupied the upstairs apartment in the 1940s through the 1960s stashed his mercury supply below the floor of his apartment (and above the ceiling of the apartment below). Dentists in those days used mercury to create fillings for their patients’ teeth. Eventually, the insured theorized, the mercury simply ate through its container. The insurer disputed this story as speculation and denied coverage, relying on a pollution exclusion clause.

The court reviewed the pollution exclusion clause and considered the history behind such clauses. Notably, the court relied on *Stoney Run Co. v. Prudential-LMI Commercial Insurance Co.*, 47 F.3d 34 (2d Cir. 1995), to conclude that the pollution exclusion clause’s

purpose was to exclude coverage only for “environmental” pollution. If that is the construction in this case, the insurer must pay because “the mercury leaking into Apartment 2 at 55 West 8th Street from the ceiling cannot be characterized as ‘environmental’ in nature.” But after noting that other portions of the policy indicated an intent to exclude “leakage from fire extinguishing equipment”— not an “environmental” harm, yet specifically excluded — the court declared the exclusion ambiguous.

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## FROM REGULATORS AND LEGISLATORS

### CONNECTICUT

- The Insurance Department issued a bulletin warning insurers and agents of poaching other insurers’ clients by reference to the financial strength of the other insurer. [Bulletin IC-22 - Industry Responsibility Concerning Public Confidence/Unfair Trade Practices, Replacements and Sales Promotion](#).
- A regulation has been implemented concerning foreign and alien insurers submission of financial statements to the Department. [Surplus Lines Insurers Regulation](#)

### NEW YORK

- The Superintendent issued a circular letter concerning compliance by licensees with regard to three federal laws: the Bank Secrecy Act; Foreign Corrupt Practices Act; and the Office of Foreign Assets Control. As part of its future examination processes, the Department may make limited inquiry into a licensee’s compliance function to assess how well the licensee takes into consideration the risks of money laundering, bribery of foreign persons, and recognition of federal economic sanctions. The review will be done within the normal review of a company’s overall compliance function. [Circular Letter No. 11 \(2009\)](#).

### NEW JERSEY

- The State is expected to enact an amendment to its medical malpractice reporting requirement. The amendment provides that when an insurer pays a settlement pursuant to a high/low agreement, the insurer does not have to report the settlement when a court or arbitrator issues a judgment or finding of no liability on the part of the practitioner. [Medical Malpractice Reporting Requirements Proposed Amendment: N.J.A.C. 11:1-7.3](#).