

The Complex Insurance Coverage Reporter: September 2024

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9.27.24

ARBITRATION

S.K.A.V., LLC v. Indep. Specialty Ins. Co., 103 F.4th 1121 (5th Cir. 2024)

Fifth Circuit predicts that, as amended, a Louisiana statute (Revised Statute § 22:868)* prohibiting certain insurance contracts from depriving courts there of "the jurisdiction or venue of action against the insurer" would void an arbitration provision in a surplus lines policy. According to the court, it was "settled" that arbitration agreements were unenforceable under statute until a 2020 amendment (Subsection (D)) authorized surplus lines insurers to include forum and venue selection provisions in policies. It concluded that, notwithstanding the amendment, arbitration clauses are a qualitatively different type of forum-selection clause, at least for purposes of the statute, since they have jurisdictional import and thus continue to fall under the prohibition of Subsection (A)(2). The Fifth Circuit did so over the objection that freedom of contract is especially important due to the "acutely high risks" in surplus lines insurance: "General principles of contractual freedom, however normatively attractive in the surplus lines insurance business, cannot trump specific statutory commands," the court said.

* Section 22:868 of the Louisiana Revised Statutes provides in part:

A. No insurance contract delivered or issued for delivery in this state and covering subjects located, resident, or to be performed in this state, or any group health and accident policy insuring a resident of this state regardless of where made or delivered, shall contain any condition, stipulation, or agreement either . . .

(2) Depriving the courts of this state of the jurisdiction or venue of action against the insurer. . . .

The 2020 amendment at issue states:

D. The provisions of Subsection A of this Section shall not prohibit a forum or venue selection clause in a policy form that is not subject to approval by the Department of Insurance.

Note: At least fourteen other states have statutes prohibiting mandatory arbitration provisions in insurance policies. Ark. Code Ann. § 16-108-233(b) (2011); Ga. Code Ann. § 9-9-2(c)(3) (2019); Haw. Rev. Stat. § 431:10-221 (1987); Ky. Rev. Stat. Ann. § 417.050(2) (2019); La. Stat. Ann. § 22:868 (2020); Md. Code Ann., Cts. & Jud. Proc. § 3-206.1 (2009); Mo. Ann. Stat. § 435.350 (1996); Neb. Rev. Stat. Ann. § 25-2602.01(f)(4) (2010); Okla. Stat. Tit. 12, § 1855(D) (2008); 10 R.I. Gen. Laws Ann. § 10-3-2 (1998); S.C. Code Ann. § 15-48-10(b)(4) (1978); S.D. Codified Laws § 21-25A-3 (1997); Va. Code Ann. § 38.2-312 (1986); Wash. Rev. Code Ann. § 48.18.200 (2019).

CONTAMINANTS-POLLUTANTS EXCLUSION

Lockner v. Farmers Ins. Co. of Or., 2024 Or. App. LEXIS 734 (Or. Ct. App., June 5, 2024)

Oregon appeals court holds that a "contaminants exclusion" in a landlord's property policy that insures for "accidental direct physical loss" except as provided barred coverage for damage allegedly caused by a tenant's personal use of methamphetamine. The policy provides in part that it does not "insure for loss either consisting of, or caused directly or indirectly by. . . [the] release, discharge or dispersal of contaminants, pollutants, insecticides, or hazardous gasses or chemicals." The court held that the damage to the dwelling and HVAC system was caused by the release of contaminants from smoking meth and coverage is thus barred by the "contaminants exclusion." It distinguished an earlier case [*Largent v. State Farm Fire & Cas. Co.*, 842 P.2d 445 (Or. Ct. App. 1992)] involving a meth operation and different exclusion, which it said listed "contamination" along with other terms like "wear and tear" that "represented gradual processes," and did not apply to "sudden damage" such as occurs from production. The court also rejected the policyholder's argument that the loss qualified as covered "vandalism" under the "efficient proximate cause" rule since there was no evidence the tenant intended to cause damage or knew or should have known it was likely to occur (i.e., "the personal use of [meth] is not vandalism") and the rule did not apply as the record established only one relevant cause of damage.

POLLUTION EXCLUSION

St. Paul Fire & Marine Ins. Co. v. Getty Props. Corp., 213 N.Y.S.3d 185 (N.Y. App. Div. 2024)

New York appeals court holds that pollution exclusions (including "sudden and accidental" exclusions) contained in the CGL policies at issue precluded coverage for claims alleging environmental contamination from releases of the fuel additive methyl tertiary butyl ether (MTBE), which qualifies as a pollutant. The court rejected arguments by the policyholder that MTBE could not be considered a pollutant allegedly because it did not know MTBE was harmful and its use as an additive was required by EPA. The policies at issue "make no mention of the legality of the insured's use or release of the claimed pollutant, and the [New York] Court of Appeals has rejected an insured's claim that if discharge of a substance was legal, it could not be considered a pollutant under a pollution exclusion," the court said. It concluded the exclusions were shown to apply, "regardless of whether MTBE was 'specifically named as a pollutant' or whether MTBE 'was understood to have a detrimental effect on the environment at the time the policy was entered into,'" and that the temporal aspect of policies with "sudden and accidental" exclusions was not met given that the pollution alleged "occurred undetected over many years."

PROFESSIONAL SERVICES EXCLUSION

Allied Design Consultants, Inc. v. Pekin Ins. Co., 2024 Ill. App. LEXIS 1433 (Ill. Ct. App., June 18, 2024)

Illinois appeals court holds that forms of a professional services exclusion* in the businessowners and commercial umbrella policies at issue preclude a duty to defend underlying personal injury suits against a design firm-insured involving a carbon monoxide leak at a school building where it is alleged to have contracted to perform architectural services and to conduct a health/safety survey. The policyholder argued the pleadings alleged "negligent acts of failure to warn, maintain, repair, and follow the manufacturer's directions" relating to water heaters and venting that leaked and that do not involve professional services, but the court disagreed. It referred to prior authority that noted courts had adopted "an expansive definition of the term 'professional service'" which is not limited to services performed by someone who must be licensed to practice their profession; rather, it means "any business activity conducted by the insured which involves specialized knowledge, labor, or skill, and is predominantly mental or intellectual as opposed to physical or manual in nature." The exclusions applied including since, as the court explained, the alleged failures there (1) to warn about and remedy issues with the water heaters must have resulted from the claimed failure to properly conduct the survey, which the policyholder did not dispute fell within the exclusion; (2) to warn and follow manufacturer documents are "clearly not physical or manual in nature;" and (3) to remedy the mechanical systems "requires specialized knowledge and would be predominantly mental or intellectual in nature."

*The exclusion in the businessowners policy provides that the policy does not apply to "[b]odily injury", 'property damage', or 'advertising injury' due to rendering and failure to render any professional service. This includes but is not limited to:

- (1) Legal, accounting, or advertising services;
- (2) Preparing, approving, or failing to prepare or approve maps, drawings, opinions, reports, surveys, change orders, designs or specifications;
- (3) Supervisory, inspection or engineering services[.]"

The umbrella policy excludes "[a]ny damages because of 'professional liability.'" "Professional liability" is defined as "legal liability for damages due to the rendering of or failure to render any professional services, in the practice of the insured's profession, by the insured or any person acting under the insured's direction, control, or supervision." It provides a "nonexclusive" list of professions including "[a]rchitects, engineers, surveyors, or draftsmen."

Cases to Watch

Crabtree v. Allstate Prop. & Cas. Ins. Co., No. 2024-FC-00827-SCT (Miss.) (Champerty; Litigation Funding)

Mississippi Supreme Court to decide, on certified question from the Fifth Circuit, whether the state's champerty* statute (Miss. Code Ann. § 97-9-11) voids an assignment of a cause of action to a disinterested third-party. At issue are claims against an insurer for alleged "bad faith" that were purchased from its insured in bankruptcy by underlying personal injury claimants who had obtained a judgment against the insured (the claim was classified as an asset of the bankruptcy estate). The insured assigned the claim to an entity retained by the claimants to finance the purchase, which, in turn, assigned it to the claimants subject to repayment if they prevailed in their suit against the insurer. The federal district court in the case found both assignments champertous and void under the statute, which deprived it of jurisdiction (i.e., the claimants did not lawfully possess the claim and therefore lacked standing to sue).

On appeal, the claimants argue champerty is not available to the insurer as a defense or, alternatively, the assignments were valid. Among other things, the Fifth Circuit states that resolution of the issue and clarification as to when parties may assign claims "could have major implications for the booming litigation-funding industry." It therefore certified the following question:

Does Miss. Code Ann. § 97-9-11 (Rev. 2013) allow a creditor in bankruptcy to engage a disinterested third party to purchase a cause of action from a debtor?

* The Fifth Circuit cites the following definition: "Champerty is generally defined as a bargain between a stranger and a party to a lawsuit by which the stranger pursues the party's claim in consideration of receiving part of any judgment proceeds." According to the court, under Mississippi law, parties to a champertous agreement are subject to criminal prosecution and may not enforce the agreement against each other, but a stranger to the agreement cannot invoke champerty as a defense in a civil action.

Hill Hotel Owner, LLC v. Hanover Ins. Co., No. 2024SA113 (Colo.) (Attorney-Client Privilege)

Colorado Supreme Court to review whether communications between a first-party property insurer's outside counsel and engineering consultants during the insurer's pre-litigation claim investigation are privileged. According to court filings, the communications relate to technical issues arising from a construction defect claim for which the insured was seeking coverage under a builder's risk policy. The trial court granted the insured's motion to compel production of the communications on the grounds they were not prepared in

anticipation of litigation and, therefore, not protected by the attorney-client privilege. In a petition for rule to show cause, which the Supreme Court granted, the insurer argues that the trial court erred because “anticipation of litigation is simply not an element of Colorado’s attorney-client privilege” and it failed to “address[] the undisputed evidence that the communications in question were for purposes of [the insurer] obtaining legal assistance.” The insurer also argues that guidance from the Supreme Court will help resolve a “growing privilege crisis” in Colorado resulting from trial court’s divergent application of “the basic test for privilege.”

North River Ins. Co. v. James River Ins. Co., No. 89228 (Nev.) (Equitable Subrogation; Primary/Excess Insurance)

Nevada Supreme Court asked to determine, on certified question from the Ninth Circuit, whether an excess liability insurer can pursue an equitable subrogation claim against a primary insurer where an underlying suit is settled within the insurers’ collective limits. After initially rejecting settlement demands from the underlying plaintiff within its \$1 million limit reportedly despite defense counsel’s opinion that the case’s value exceeded \$1 million, the primary insurer ultimately agreed to pay its full limit toward a \$5 million settlement. The excess insurer contributed \$4 million of its \$10 million limit and then sued the primary insurer, arguing it had the right to step into the insured’s shoes as a subrogee on a claim for “bad faith” failure to settle within limits. The Ninth Circuit concluded that, although the Nevada Supreme Court had held in two unpublished decisions* that an excess insurer has no equitable subrogation claim where a suit settles within the combined primary and excess limits and the insured thus suffers no damages, those decisions were not “mandatory precedent” under Nevada appellate rules, not decided by a full Nevada Supreme Court, and factually/procedurally distinguishable. “Left with no clearly controlling precedent,” the Ninth Circuit believed the state high court should be the first to consider the issue and, therefore, certified the following question:

Under Nevada law, can an excess insurer state a claim for equitable subrogation against a primary insurer where the underlying lawsuit settled within the combined policy limits of the insurers?

* *St. Paul Fire & Marine Ins. Co. v. Nat’l Union Fire Ins. Co.*, 521 P.3d 418, 2022 Nev. Unpub. LEXIS 863 (Nev. 2022); *Aspen Specialty Ins. Co. v. Eighth Judicial Dist. Ct. of Nev.*, 528 P.3d 287, 2023 Nev. Unpub. LEXIS 290 (Nev. 2023).

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