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Think You're Covered? Prepare For a Boxing Match

By William G. Passannante

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Insurance buyers expect that an insurance policy should provide protection from loss, not a fifteen-round fight to the finish. More and more frequently, insurance companies have been eliminating the promise of protection through unfair claims handling, or by attempts to undo the insurance promise altogether through rescission. Indeed, one major insurance company reportedly has commenced 100 rescission attempts. No wonder policyholders feel as though a "standing eight count" is needed every time they need their insurance company to pay a significant claim.

Several areas of insurance have been hard-hit with increasingly restrictive claims-handling or rescission attempts. For example, some of the current fight can be divided into two "Rounds": (Round One) D&O liability insurance; and (Round Two) general liability insurance for products liability. The insurance promise—that darling of the insurance sales force—has become more and more difficult to actually obtain.

Round One: D&O Liability Insurance

An insurance market dominated by headlines regarding alleged accounting fraud and stock market meltdowns amplifies the need for Directors and Officers liability insurance coverage. Insurance companies recently have been racing to "rescind" D&O policies after significant losses. Tyco, Adelphia and Xerox offer cautionary tales.

Tyco—Rescission Attempt by Chubb

Federal Insurance Company (part of Chubb) sued Tyco and its directors and Officers in Supreme Court, New York County. Federal sought a declaration from the court that the D&O liability insurance policies sold by Federal to Tyco had been rescinded and that exclusions in the policies barred insurance coverage for.

Former Tyco CEO Dennis Kozlowski counterclaimed and asked the Court to require Federal immediately to defend him. Hon. Justice of the Supreme Court in New York, Helen E. Freedman stated:

> [F]ederal's unproven rescission claim does not affect its present obligation to defend Kozlowski or pay his defense costs under the Policies. However, if Federal ultimately prevails in this action and the Policies are declared to be void ab initio, Federal may be able to recover its costs for the defense it has provided Kozlowski.

The Court had divided the cases into three categories, which the Court described as: (1) the "ERISA Action;" (2) the "Securities Action;" and (3) the "Criminal Action." With regard to the ERISA Action, the Court stated:

" If ever there was a 'sucker punch' in claims handling, it is rescission."

> The "personal profit" exclusion in the Policies does not excuse Federal from coverage, inasmuch as the ERISA Action plaintiffs do not allege that Kozlowski personally profited from his breach of fiduciary duty. Accordingly, Federal is obligated to defend Kozlowski in the ERISA Action.

With regard to the Securities Action, the Court stated:

> Although Kozlowski may have indirectly profited from this alleged misconduct, the "personal profit" exclusion does not apply because the plaintiffs' claims against Kozlowski are based upon his alleged misstatements and omissions and the harm they caused plaintiffs. Thus, Federal is obligated to pay Kozlowski's defense costs in the Securities Action.

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Anderson Kill & Olick, P.C. is pleased to announce the following promotions:

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We are pleased to announce the relocation of the Illinois office:

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With regard to the Criminal Action, the Court stated:

> Since this count and others do not fall within the coverage exclusion, Federal's duty to provide defense costs extends to the entire Criminal Action. Of course, this determination has no bearing on Kozlowski's guilt or innocence in the Criminal Action, or his liability to the plaintiffs in the ERISA and Securities Actions.

Federal Insurance Company v. Tyco International Ltd., et al., No. 600507/03, Sup. Ct. NY, 2 Misc.3d 1006(A), 2004 WL 583829 (decided March 5, 2004).

Adelphia—Rescission Attempt by AEGIS

AEGIS Insurance Company and two excess insurance companies sued a number of the directors of Adelphia, including Rigas family members, seeking a judicial declaration that the D&O insurance policy sold to Adelphia had been rescinded and that exclusions in the policies barred insurance coverage.

The D&Os moved for partial summary judgment asking the court to order AEGIS to advance their defense costs pending ultimate resolution of the rescission case and the alleged policy exclusions.

Justice Michael Baylson of the Pennsylvania Federal District Court ordered the D&O insurance companies to advance legal costs until there was resolution of the rescission and coverage defenses. In his opinion, Judge Baylson stated that:

> "Insurance carriers do not function as courts of law. If a carrier wants the unilateral right to refuse a payment called for in the policy, the policy should clearly state that right."

The Adelphia ruling forced AEGIS to pay the bills of a number of D&O's, up to the current $300,000 limit set by the judge overseeing Adelphia's bankruptcy.

Xerox—Rescission Attempt by AIG

National Union (AIG) sold a D&O insurance policy to Xerox. Xerox had audited financial statements when it applied for the insurance. Xerox, its officers, directors and its auditors KMPG, LLP were sued for among other things allegedly defrauding investors. The Xerox financials are the cornerstone of the lawsuits. AIG sued Xerox asking for rescission of the D&O insurance policy. AIG based its rescission claim on the very same allegedly false financial statements. *National Union Fire Insurance Company of*

"...the Court observed that nothing is so easy as to be wise after the event."

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Pittsburgh, PA. v. Xerox Corporation, et al., No. 03603360, Sup. Ct. NY (dated October 24, 2003).

Insurance companies repeatedly have threatened to avoid the D&O policies they sold by rescinding them. If ever there was a "sucker punch" in claims handling, it is rescission.

Round Two: General Liability Insurance Policies for Products Liability

If rescission claims are a "sucker punch," the misuse of "polluter's exclusions" is hitting "below the belt." Insurance companies misuse so-called "polluter's exclusions" in an attempt to exclude garden variety products liability claims clearly intended to be covered under the policies. Examples include claims involving lead-pigmented paint, carbon monoxide, or asbestos.

While it may seem obvious that lead-pigmented paint on the walls of a home is not a "pollutant," insurance companies continue to attempt to avoid their contractual obligations by arguing that the so-called "polluter's exclusion" bars coverage for such claims. In 1985 the industry once again redrafted the standard general liability policy, this time creating what insurance companies call an "absolute pollution exclusion." Numerous courts nationwide, however, have rejected the notion that it is indeed "absolute." Alleged liability for in-place lead-pigmented paint simply does not fall within any a pollution "incident," and should not be excluded by the terms of the 1985 "polluter's exclusion."

The United States Court of Appeals for the Second Circuit held that the 1985 "polluter's exclusion" does not apply where the alleged liability is not due to environmental pollution. The Second Circuit determined that "it is reasonable to interpret that clause as applying only to environmental pollution." In reaching its conclusion, the Second Circuit recognized that the 1985 "polluter's exclusion" did not apply to injuries caused by exposure to carbon monoxide in an apartment. The Second Circuit noted in its analysis that the insurance companies in *Stoney Run* had attempted to contrast injuries caused by exposure to "useful products" such as lead pigmented paint, with injuries caused by carbon monoxide which, the insurance companies argued, is a "toxic byproduct."

If, as the Second Circuit held in *Stoney Run*, carbon monoxide, "a toxic byproduct without a useful purpose" when released into an apartment "is not the type of environmental pollution contemplated by the pollution exclusion clause," then "useful products, such as . . . lead paint" cannot be environmental pollution either. The holding in *Stoney Run* applies with added vigor to claims involving lead-pigmented paint. As the United States Court of Appeals for the First Circuit observed in dicta, "[a]n objectively reasonable person simply would not ascribe the word 'pollution' to the presence of lead paint in a house."

Courts have rejected other attempts to apply similar "polluter's exclusions" to other types of non-environmental claims. In *Rapid-American Corp.*, the New York Court of Appeals stated that the "sudden and accidental" polluter's exclusion operates to applies

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UPCOMING EVENTS

First Annual D&O Insurance Luncheon Seminar

William G. Passannante

Anderson Kill & Olick, P.C. is pleased to announce that William G. Passannante will chair the firm's **First Annual D&O Insurance Luncheon** Seminar on Wednesday, October 13, 2004, from 12-2 p.m. at the Harvard Club, New York City. Mr. Passannante is co-chair of the firm's Insurance Recovery Group and Vice Chair of the Professionals, Officers and Directors Liability Committee of the Tort and Insurance Practice Section of the American Bar Association. For more information or to register for this seminar, please visit our website at www.andersonkill.com.

Seventh Annual Policyholder Advisor Conference

Anderson Kill & Olick, P.C. will be holding its **Seventh Annual Policyholder Advisor Conference** entitled "Getting Your Claim Paid," in New York City at the Sofitel Hotel on Friday, November 5, 2004, from 12:15-5:30 p.m. (Refreshments 5:30-6:30). Look for our flyer in the upcoming August/September issue of the *Policyholder Advisor* Newsletter.

a WHO SAID WHAT?

ITT Hartford Insurance Co., Appellee's Brief and Request for Oral Argument, filed Sept. 30, 1999, at 15, *Gibson v. ITT Hartford Insurance Co.*, No. 99-0386 (Iowa)

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only to "environmental pollution":

> exclude coverage for environmental pollution. The terms used in the exclusion to describe the method of pollution—such as "discharge" and "dispersal"—are terms of art in environmental law used with reference to damage or injury caused by disposal or containment of hazardous waste.

Although members of the insurance industry continue to refer to the 1985 "polluter's exclusion" as "absolute" when presented with claims, in practice the exclusion often is interpreted otherwise. Avoid the punch "below the belt" when your insurance company attempts to exclude a commonplace products claim by asserting a "polluter's exclusion."

The Final Bell—What Should You Do?

When confronted with the latest pugilistic tendencies of your friendly insurance company, what should you do to keep up your guard? Here are some tips: (1) Work with your broker to get the best result possible without a fight; (2) Do not take 'No' for an answer—assertive policyholders achieve better results; (3) The policyholder should develop the claim so it can choose the time and place for any dispute; (4) Avoid problems with counsel such as arguments disqualification of counsel through work on both defense of claim and coverage issues; and finally (5) Cover your chin and jab. ■

Mr. Passannante is a senior shareholder in the New York Office of Anderson Kill & Olick, P.C., Co-Chair of the Firm's Insurance Recovery Group, and a member of the Firm's Executive Committee. Mr. Passannante regularly represents policyholders in insurance coverage disputes. The firm has offices in New York, Chicago, Greenwich, Newark, Philadelphia and Washington, D.C.

AKO Policyholder Advisor is published every two months by Anderson Kill & Olick, P.C. The Firm has offices in New York, Washington, Chicago, Philadelphia and Newark. The newsletter informs clients, friends, and fellow professionals of developments in insurance coverage law. The newsletter is available free of charge to interested parties. The articles appearing in **AKO Policyholder Advisor** do not constitute legal advice or opinion. Such advice and opinion are provided by the Firm only upon engagement with respect to specific factual situations. For more information, contact our Editorial Board:

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